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Supreme Court, U.S.
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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1971

~~71-~~ 346

Docket No.....

DAVID M. CRAWFORD,

Petitioner,

v.

SECURITIES EXCHANGE COMMISSION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

David M. Crawford, pro se
200 Park Avenue
New York, New York 10017

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To the Honorable Warren E. Burger, Chief
Justice, and the Honorable Associate
Justices of the Supreme Court of the
United States:

Your petitioner, David M. Crawford, respectfully prays that a writ of certiorari issue to review the judgments of the United States Court of Appeals for the Second Circuit entered in this proceeding on December 9, 1968 (App. A 172-3a)* and on June 10, 1971 (App. A 234a). This is a companion petition to petitions filed on behalf of other defendants in an action brought by the Securities and Exchange Commission ("SEC") against the Texas Gulf Sulphur Company ("Texas Gulf") et al.

OPINIONS BELOW

The opinion and judgment of the United States District Court for the Southern District of New York (Bonsal, J) on the law was entered August 16, 1966 (258 F. Supp. 262) (App. A-1-65a). The appeal from the District Court's order of August 16, 1966 was argued before a three-judge panel March 20, 1967 and on May 2, 1968, prior to any decision the case was ordered en banc (Add. infra, 1).

The opinion of the United States Court of Appeals for the Second Circuit was filed

*Unless otherwise indicated references in this petition are: Judgments and opinions below, Appendix A to White & Case Petition "(App. A)"; Constitutional Amendments Statutes and Rules: Appendix B to White & Case Petition "(App. B) and Addendum to this petition (Add. infra,) Joint Appendix Before The Court of Appeals (JA). Exhibits to Joint Appendix before the Court of Appeals. (e).

August 13, 1968 (401 F. 2d. 833) (App. A 66-171a). The opinion of the United States District Court for the Southern District of New York on the remedies was filed February 6, 1970 (312 F. Supp. 77) (App. A 175-214a). The opinion of the United States Court of Appeals for the Second Circuit was filed on June 10, 1971 (App. A 220a).

JURISDICTION

The Court of Appeals entered judgment on December 9, 1968 (App. A 172-3a) and on June 10, 1971 (App. A 234a) and this petition for certiorari was filed within ninety days of the latter date. The jurisdiction of this court is invoked under 28 U.S.C. 1254 (1).

QUESTIONS PRESENTED

1. Does a decision rendered by an en banc Court of Appeals on an original hearing contravene 28 U.S.C. 46(c) and (d) and the Due Process Clause of the Fifth Amendment when oral argument is permitted before only three of the nine judges, two less than the statutory quorum?

2. Does an officer's purchase of stock on a national securities exchange on information which he believes to be available to the public, constitute fraud or deceit under §10(b) of the Securities Exchange Act of 1934 and Rule 10b-5?

3. Is an officer guilty of fraud or deceit for failing to comply with a standard of conduct proposed for the first time in the complaint herein?

4. Does Rule 10(b)-5, as construed by the Securities and Exchange Commission and the Court below, provide the ascertainable standard of conduct required by the Fifth Amendment to the United States Constitution?

5. Are the equal protection and due process provisions of the Fifth Amendment violated by enjoining petitioner for life, pursuant to §10(b) and Rule 10(b)-5 when the conduct enjoined is not stated in the section or the rule and the Congress has specifically rejected enacting legislation prohibiting the conduct enjoined?

6. Can Section 10(b) and Rule 10(b)-5 be violated by conduct which is neither manipulative or deceptive?

CONSTITUTIONAL PROVISIONS, STATUTES, RULES AND COURT ORDERS INVOLVED

Constitution of the United States Amendment V (App. B 235a).

Court of Appeals for the Second Circuit, Order of May 2, 1968 (Add. infra, 1).

28 U.S.C. 46 (c) and (d) (Add. infra, 1).

15 U.S.C. 78j (b) (App B 235-6a).

17 C.F.R. 240 10(b)-5 (App. B 238a).

Federal Rules of Appellate Procedure 35(a) and 40(a) (Add. infra 2).

Securities and Exchange Commission Rule 2(e) (Add. infra 3).

STATEMENT OF THE CASE

1. Prior Proceedings

The SEC filed its complaint April 19, 1965 demanding rescission or restitution and an injunction; the answer denied liability and asserted various defenses. In his first opinion (App. A 1-63a) the District Judge held that the stock exchange purchase by petitioner of his company's stock, violated §10b of the Securities Exchange Act of 1934 (15 U.S.C. 78j(b) (App. B 235-6a) and Rule 10b-5 promulgated thereunder (App. B 238a).

The original hearing on appeal from the District Judge's order was argued March 20, 1967 before a three-judge panel. More than a year later, on May 2, 1968, no decision having been rendered by the panel, upon motion of the active circuit judges, the appeal was ordered en banc without further argument so that only three of the nine judges heard argument on the original hearing. (Add. infra, 1).

On August 13, 1968 the Court of Appeals affirmed the finding that appellant had violated 15 U.S.C. 78j (b) and Rule 10b-5 and remanded the action to the District Court to determine the remedy to be applied against petitioner (App. A 172-3a), the question of relief, if any, having been reserved for a separate hearing.

Petitioner and other defendents filed a petition for rehearing September 20, 1968 which noted that only three of the nine judges had heard oral argument. The petition was denied without opinion October 15, 1968 (Add. infra, 4).

Hearings were held before the District Judge October 6, 7, and 8, 1969. No evidence was introduced by the SEC during the hearing that petitioner was engaged or about to engage in any conduct that violated or was likely to violate §10(b) and Rule 10(b)-5.

On February 6, 1970, the District Judge rendered his decision and opinion that petitioner should be enjoined and on April 16, 1970, entered judgment permanently enjoining petitioner "from engaging in the purchase or sale of Texas Gulf Sulphur Company securities on the basis of undisclosed material information relating to Texas Gulf Sulphur Company acquired by (petitioner) by reason of any relationship with Texas Gulf Sulphur Company or its agents or employees" (App.A 216a).

The appeal from the District Judge's order was heard by a three-judge panel May 11, 1971. On June 10, 1971 the Court of Appeals affirmed the District Court's decision and judgment (App. A 220a).

On July 7, 1971 the Court of Appeals ordered a stay of its mandate until July 31, 1971 and on August 3, 1971 ordered a stay of its mandate until September 8, 1971.

2. The Facts and Decisions Below

Petitioner was employed by Texas Gulf Sulphur Company in January 1964 and became Corporate Secretary and Manager of Public and Government Relations on February 20, 1964.

On April 15-16, 1964, petitioner believing that the news of Texas Gulf's discovery had already been announced on the Company's behalf on television and radio by Mr. Wardrope, the Ontario Minister of Mines, ordered 600 shares of his Company's stock. (Add. infra, 5-7). As petitioner believed it would be his order was executed more than 10 hours after the announcement on which petitioner relied was to have been made. (App. A 101a).

The Minister of Mines announcement was written for him by the Texas Gulf Vice President for Exploration on the morning of April 15 and was scheduled for release on television and radio at 11 p.m., April 15, 1964. (Add. infra, 5-7).

Petitioner believed that following the Minister of Mines announcement, it would be proper to place an order for his Company's stock particularly since the order could not be acted upon for at least ten hours while news of the discovery would be circulating in the public domain. Unbeknownst to anyone in the Company at the time, the Minister of Mines released the announcement to the press gallery of the Ontario Legislature in Toronto at 9:40 a.m., April 16.

Petitioner's purchase was not executed until after the company authorized announcement had been released; as Judge Waterman said:

> "...all of which transpired prior to the anticipated execution of his purchase order..." (App. A 101a).

On the remand the SEC introduced no evidence as to what remedy if any was appropriate as to petitioner. Petitioner testified without contradiction that in a conversation with Mr. Burger of the New York Stock Exchange, Department of Stock List, on April 16, 1964, the same day the stock was purchased:

> "Mr. Burger called me on the afternoon of April 16, and the message was on my desk and when I called him back he asked me--he referred to the trading in Texas Gulf Company shares that day and asked if any of the officers or directors had purchased shares. And I said that I did not know about any of the others but that I had, and if I had inadvertently, unwittingly done anything wrong, that I would be glad to do whatever was necessary to rectify it." (316 JA).

Prior to joining Texas Gulf, petitioner had graduated from Cornell University with an AB in 1938 and from the Yale Law School with an LLB in 1941 where he was Director of the Yale Moot Court. Petitioner was admitted to the New York Bar in 1941 and the Illinois Bar in 1963.

While in his last year at law school petitioner joined the Navy and served in

the Cruiser Vincennes in the winter of 1940. Following graduation in June 1941 he went on active duty serving in Naval Intelligence, at sea in the Atlantic, and in the Battle for Leyte Gulf; petitioner's last command was a Navy tanker in the Pacific.

From 1946 to 1948 petitioner was associated with Lord, Day & Lord and taught an Admirality Seminar at the Yale Law School. In 1948 petitioner joined the General Counsel's office of the Marshall Plan serving in Washington, Athens and Paris. He is the author of "United States Foreign Assistance Legislation 1947-1948" 58 YLJ 871 (1949) and "Negotiated Settlements : Anglo-Iranian Oil Company and Suez Canal Cases." p. 427 in "The Rights and Duties of Private Investors Abroad" Matthew Bender & Co. (1965).

In 1951 petitioner joined the General Counsel's office of Socony Vacuum Oil Company and in 1958 became Manger of their Office of Intergovernmental Affairs. In 1961 petitioner became Secretary and General Counsel of Abbott Laboratories and in 1964 became Secretary and Manager of Public and Government Relations for Texas Gulf.

REASONS FOR GRANTING THE WRIT

In view of this Court's continued concern with the role of en banc courts in appellate procedure, as expressed by Chief Justice Burger in his annual report to the American Bar Association July 5, 1971, the procedural aspects of this landmark case ought to be reviewed by this court to construe 28 U.S.C. 46(c) and (d) and en banc procedure in the original hearing of appeals in the Circuit Courts. As this Court's workload increases Courts of Appeals will more often be the courts of last resort, and it is important to all litigants that the procedure in each circuit on an original hearing en banc be clear and uniformly administered.

The substantive law of this case is equally worthy of this Court's review as it will have an important bearing on thousands of security transactions. The Second Circuit viewed the case as one of exceptional importance for it sua sponte ordered the case en banc after a three-judge panel had the case for more than a year without rendering a decision. When, after seventeen months deliberation Judge Waterman released the Second Circuit's decision and opinions to the Wall Street Journal, he emphasized the importance of the case, being quoted as saying:

> "It's going to have a hell of an impact on the financial world. Everyone in the U.S. has been waiting for this." Wall Street Journal, August 14, 1968.

A. Summary of Procedural Reasons for Review:

1. The Second Circuit's construction of 28 U.S.C. 46(c) and (d) is contrary to the holding of this court in U.S. v. American Foreign S.S. Corp. 363 U.S. 685 (1960) and the plain language of the statute and violated the due process clause of the Fifth Amendment.

2. The Second Circuit's construction of §46(c) and (d) is contrary to the construction and practice of the Courts of Appeals for the Third and Fifth Circuits when conducting original hearings en banc thus presenting a conflict between circuits which this court can most effectively resolve.

3. The Second Circuit has so far departed from the accepted and usual course of judicial proceedings in its application of 28 U.S.C. §46(c) and (d) as to call for this court's review.

B. Summary of Substantive Reasons for Review:

1. The construction given 15 U.S.C. 78j and 17 C.F.R. 240 10(b)-5 by the Second Circuit is contrary to the statute and rule and violates petitioner's rights under the Fifth Amendment.

2. The construction given 15 U.S.C. 78j and 17 C.F.R. 240 10(b)-5 by the Second Circuit is not only erroneous but also affects thousands of security transactions potentially creating a large volume of unnecessary litigation in the Federal courts.

A R G U M E N T

I

THE SECOND CIRCUIT ERRED IN DENYING PETITIONER ORAL ARGUMENT BEFORE A STATUTORY QUORUM OF THE EN BANC COURT IN AN ORIGINAL HEARING.

Section 46(c) reads in part:

> "Cases and controversies shall be heard...by a court...of not more than three judges unless a hearing...before the court in banc is ordered." (Add. infra, 1).

Section 46(d) reads:

> "A majority of the number of judges authorized to constitute a court or division thereof, as provided in paragraph (c), shall constitute a quorum."

Petitioner's appeal was heard by a three-judge panel of the Second Circuit on March 20, 1967 and on May 2, 1968, no decision having been rendered, the case was ordered en banc "without further argument" (Add. infra, 1). The judgment of the Second Circuit, dated August 13, 1968 (App. 172-3a) entered December 9, 1968, names as present all nine active judges to whom the case was ordered en banc and states:

> "This cause came on to be heard... and was argued by counsel" (App. 172-3a).

The recital of nine judges as "present" does not reflect the latent defect that only three of those nine judges, two less than

the statutory quorum, heard argument by counsel. Petitioner submits that the Second Circuit committed fundamental error and that the judgment is void and of no effect since the argument was not heard by a statutory quorum of the court as required by the controlling statute Section 46(c) and (d).

The Second Circuit leaves litigants in a quandary with respect to its en banc procedure admitting that it has:

> "...no set rule in this regard, but are guided by what we conclude are the needs of a particular case." U.S. v. Gori, 282 F. 2d 43 at 53 (1960), affirmed on other grounds, 367 U.S. 364 (1961).

The Second Circuit's admitted lack of an applicable en banc rule ought not entitle that court to disregard the requirements of a statutory quorum.

The Pennsylvania Law Review has commented that en banc practice such as that followed by the Second Circuit in petitioner's case:

> "...has been criticized however, primarily because it permits judges to whom the litigants were unable to argue their views to exert considerable influence on the disposition of a case." En banc Procedure in the Federal Courts of Appeals 111 U.Pa.L.R. 220-230 (1962).

The Second Circuit's inconsistent en banc procedure was the subject of one of Judge Clark's last opinions in Walters v. Moore McCormack Lines, Inc., 312 F. 2d. 893 (1963). Drawing on his long experience in judicial procedure as Judge and Chief Judge of the Second Circuit, Judge Clark wrote in dissenting from the Second Circuit's en banc procedure in Walters, in which Mr. Justice Marshall also dissented:

> "In view of the anomalies of our in banc procedure,illustrated in an increasing number of cases of which this is a crowning example, it seems desirable,if not necessary, to point out where we seem to have arrived or to be tending." Id. at 896.

Petitioner's case illustrates the continuing anomalies in en banc procedure in the Second Circuit; in petitioner's case "heard" was given two different meanings in the same hearing. When petitioner's case was before the three-judge panel on the original hearing "heard" meant oral argument; when petitioner's appeal was before nine judges on the original hearing "heard" meant no oral argument (Add. infra, 1). Reasons for oral argument before three judges were equally applicable to the other six en banc judges.

During its October 1959 term this Court issued a writ of certiorari to the Court of Appeals for the Second Circuit, after Chief Judge Clark and Judge Waterman had suggested in their dissenting opinion in American Foreign S.S. Corp. v. U.S. 265 F. 2d. 136 (1959) that a literal interpretation be given to the words "active" and

"determined"in Section 46(c). Mr. Justice Stewart observed in the Court's opinion upholding the literal interpretation of Section 46(c) advocated by Chief Judge Clark and Judge Waterman:

> "Certiorari was granted to consider a question of importance to the Courts of Appeals in the administration of their judicial business." U.S. v. American Foreign S.S. Corp., 363 U.S. 685 at 687 (1960).

This Court ought now review Judge Waterman's contrary interpretation of the same section of the Judicial Code on an important question affecting all Circuit Courts of Appeals in the administration of their judicial business.

Petitioner submits that pursuant to 28 U.S.C. 46(c) and (d):

> (1) "Heard" implies oral argument on an original hearing en banc, and
>
> (2) Oral argument on an original hearing en banc ought to be heard by a statutory quorum of the Court.

1. "Heard" implies oral argument on an original hearing en banc.

On May 2, 1968 when the Second Circuit ordered this case en banc it referred to the "judges who heard oral argument" thus implying that "heard" meant "oral argument." (Add. infra, 1).

Speaking for a unanimous Supreme Court, Chief Justice Hughes succinctly stated "The one who decides must hear." Morgan v. U.S. 298 U.S. 468, 481 (1936).

This Court in construing the phrases "heard and determined" and the "active circuit judges" in Section 46 has held that "The literal meaning of the words seems plain enough." U.S. v. American Foreign at 688. After analyzing the words "active" and "determined" Mr. Justice Stewart speaking for the court concluded:

> "There is nothing in the history of the legislation to indicate that these words should be understood to mean anything else than what they say." Id 688-689.

The same literal meaning should be accorded "heard" in the same section, and derogation of oral argument before a statutory quorum of the en banc court ought not be innovated by the Second Circuit. This Court laid down for the Second Circuit a literal interpretation of the terms "active" and "determined" in Section 46(c) in a case involving only statutory construction and that circuit court ought to have been as literal in its interpretation of the word "heard" in the same paragraph.

This Court ought now review the Second Circuit's failure to follow the Court's previous directive to it in U.S. v. American Foreign S.S. Corp., supra, for Mr. Justice Stewart then said of Section 46:

> "if the statute is to be changed, it is for Congress, not for us, to change it." U.S. v. American Foreign S.S. Corp. at 691.

Mr. Justice Harlan's dissent in American Foreign S. S. Corp., in which he was joined by Mr. Justice Frankfurter and Mr. Justice Brennan, also indicates that this court ought to review the Second Circuit's procedure for handling original hearings en banc. Mr. Justice Harlan construing the traditional term "heard and determined" in §46 in American Foreign S. S. Corp. stated:

> "It is not an unknown phenomenon in federal adjudication that a case, though heard by less than the entire tribunal, may be decided according to the majority vote of all. * * * The traditional term, "heard and determined" in my view was designed to do no more than reflect the obvious inappropriateness of such a procedure to the deliberations of the Court of Appeals." Id. 692.

The importance of oral argument on original hearings in the Second Circuit was recently emphasized by Chief Judge Lumbard in an address to the New York County Lawyers Association March 3, 1971 when he was reported by The New York Law Journal of March 4, 1971 as saying:

> "No matter how frivolous the arguments may be . . . he felt they should be heard."

The first sentence of Rule 34(a) of the Federal Rules of Appellate Procedure states:

> "The Clerk shall advise all parties of the time and place at which oral argument will be heard."

The special importance of oral argument to an appellant is emphasized by paragraph (e) of Rule 34:

> "If the appellee fails to appear to present argument, the court will hear argument on behalf of the appellant if present. If the appellant fails to appear, the court may hear argument on behalf of the appellee, if his counsel is present."

The importance this court attaches to oral argument is emphasized by its Rule 45 (1) which states in part: "The Court looks with disfavor on the submission of cases on briefs, without oral argument...," and Mr. Justice Brennan has observed:

> "...every member of the Court brings to the ultimate disposition of the case his judgment based on the full briefs and the oral arguments." Eaton v. Price 360 U.S. 246, 247 (1959).

Federal Rule of Appellate Procedure 35a (Add. infra, 2) provides that en banc courts may be convened in cases involving questions of exceptional importance, and this Court has stated:

> "En banc courts are the exception, not the rule. They are convened only when extraordinary circumstances exist that call for authoritative consideration and decision by those charged with the administration and development of the law of the circuit." U.S. v. American Foreign S.S. Corp., 363 U.S. at 689.

Chief Justice Vinson stated that §46(c) is a codification of Textile Mills v. Com. 314 U.S. 326 (1943) which was this Court's

approval of the en banc procedure structured by the Court of Appeals for the Third Circuit. Western Pacific R. R. Corp. v. Western Pacific R. R. Co. 345 U.S. 247 at 256 (1953).

When Mr. Justice Douglas in Textile Mills approved for a unanimous court the en banc procedure on original hearings evolved by the Third Circuit, he referred to:

> "...the most important function of the 'court' (the hearing and the decision of appeals).." Id. 333.

In the Third Circuit parties were allowed oral argument on original hearings en banc before a majority of the court. When Textile Mills was before the Third Circuit Judge Biggs stated with respect to the en banc procedure in that case:

> "This case was originally heard by three circuit judges but before its decision this court, by special order, directed that it be reheard by the Court en banc, consisting of the five circuit judges of the circuit in active service. The case has now been heard and considered by the Court En Banc." Com. v. Textile Mills S. Corp. 117 F. 2d 62 at 67 (1940).

Thus the en banc procedure on original hearings codified as Sec. 46 included oral argument before a majority of judges i.e., a statutory quorum. The legislative history of §46 reveals no Congressional intention of eliminating the right to oral argument before en banc courts on original hearings.

In U. S. v. American Foreign S.S., supra, Mr. Justice Stewart cited Judge Maris of the Court of Appeals for the Third Circuit as an authority on en banc procedure. Id. 690. Judge Maris, one of the three judges of the Judicial Conference Committee on the revision of the Judicial Code which became the 1948 Judicial Code, indicates in his monograph on en banc procedure entitled "Hearing and Rehearing Cases en Banc," that in an original hearing en banc, oral argument is heard. 14 F.R.D. 91 (1954). Summarizing the Third Circuit's procedure, Judge Maris writes:

> "If following the circulation of a draft opinion, four circuit judges request that the case be reargued en banc the hearing panel enters an order setting the case down for reargument en banc." Id. 93.

Since July 1, 1968, after petitioner's case was ordered en banc, the Court of Appeals for the Fifth Circuit pursuant to its Rule 18 has established a screening procedure for denying oral argument in certain appeals before a three-judge panel. However, if a single judge of the panel feels oral argument should be heard it is heard. Moreover, the Fifth Circuit allows oral argument on an original hearing when a case is of such importance that it is referred en banc prior to a decision by the three-judge panel. Allen v. Johnson 391 F. 2d. 527 (Fifth Cir. 1968) 413 F. 2d. 1218 (1969).

In petitioner's case the Second Circuit relied on Western Pacific supra, and Shenker v. B. & O., 374 U.S. 1 (1963) observing that §46(c) was addressed to the Court and not to litigants (App. A 232a). Petitioner submits

that the holding of Western Pacific and Shenker is limited to the principle that the determination as to whether an appeal will be ordered to be heard or reheard en banc is an intramural decision to be made by the Court. Petitioner suggests that no matter to whom §46(c) and (d) are addressed they require that oral argument on the original hearing "shall be heard" by a statutory quorum of the en banc court, and that it does not follow that the en banc court has the right to disregard the plain language of the statute to "hear" the appeal simply because it has the power to determine whether or not it will sit en banc.

If, as the Second Circuit has held, "heard" does not imply "oral argument" on an original hearing en banc because §46(c) is addressed to the courts and not to litigants, the Circuit Courts can interpret §46(c) any way they choose. Lest such power in any way flaw Circuit Court procedure, this court ought to review the questions presented.

Although FRAP 40 (a) (Add. infra, 2) specifically provides that oral argument in support of a petition for rehearing is not permitted and that the court on a rehearing may make final disposition of a case without "reargument," the fact that the rule uses the term "reargument" implies that there has been argument at the hearing stage. Petitioner's case was not a rehearing. The only petition for rehearing in this case was filed September 20, 1968, raising, inter alia,

the en banc question raised herein, and was denied without opinion October 15, 1968. The seventeen month appeal before the Second Circuit in this case was therefore still a proceeding in the original hearing stage.

In its opinion below the Second Circuit erroneously referred to the en banc court as a "rehearing" (App. A 233a). As of May 2, 1968 when the case was ordered en banc no opinion had been filed, no decision had been rendered, and no judgment had been entered so the appeal was still at the hearing stage.

In view of the conflict between Circuit Courts and in the interest of sound and uniform judicial administration this court ought to review and establish what rules are applicable when a case is ordered en banc prior to a decision.

In its opinion below the Second Circuit observed:

> "...we do not intend that anything stated in the present opinion be construed as approving or disapproving the denial of oral arguments at the initial 'hearing' on appeal..." (App. A 233 a n 10).

Petitioner's case was still at the initial hearing stage when it was referred en banc, and for the same court to deny oral argument before a statutory quorum of the en banc court in a case of exceptional importance is anomalous and fosters a confused appellate procedure.

2. Oral Argument on an Original Hearing En Banc ought to be Heard by a Statutory Quorum of the Court.

This Court was unanimous in holding that:

> "...a certificate of questions or propositions of law concerning which a Circuit Court of Appeals desires the instruction of this Court for their proper decision is irregular when a quorum of its members does not sit in the case..." Cincinnati Ry v. McKeen. 149 U.S. 259, 260-261 (1893).

The Court of Appeals for the Fifth Circuit has held that the word "Quorum" in Section 46 (d) means:

> "...such a number of the members of the court as may legally transact judicial business." Tobin v. Ramey 206 F. 2d 505, 507 (5th Cir. 1953).

Congress has established statutory quorums for the courts since the first Judicial Code of 1789 provided that a quorum of the Supreme Court would be four of six justices. 1 Stat. 74-75. The Judicial Code of 1948 does not deny litigants oral argument before a statutory quorum of the Court on an original hearing en banc and the legislative history of the code reveals no such Congressional intent.

In construing the Judicial Code of 1948 Chief Justice Vinson wrote:

> "The short answer is that there is no need to refer to the legislative history where the statutory language is clear..It is obvious that the changes in law retained in the Code were not considered as "Controversial" by these Congressional Spokesmen." Exparte Collett 337 U.S. 55 at 61-62 (1949).

These spokesmen would undoubtedly have considered denying an appellant oral argument before a statutory quorum of an en banc court on an original hearing a controversial proposal which would have at least been mentioned during the hearings since it is not specifically referred to in the statute.

Assuming arguendo, that it might be acceptable procedure to deny all en banc judges oral argument on an original hearing the incongruous result reached in the present case is anomalous judicial administration. The three judges who heard oral argument had quite a different exposure to the case in seventeen months than the six judges who heard no argument and had only one-quarter of the time to consider the case. It is possible that in the present and companion cases, the three judges who heard oral argument might have rendered a substantially different decision from that reached by the nine judges of the en banc court, six of whom heard no oral argument.

Judge Jones'statutory and constitutional reasons for declining to participate in an en banc rehearing in which oral argument was denied are even more compelling when applied to a denial of an original hearing en banc. Reynolds Aluminum Company v. N.L.R.B. 394 F. 2d 405, 409 (5th Cir. 1968).

A comprehensive two part note on En Banc Hearings in the Federal Courts of Appeals comments:

> "Even if an en banc court could be properly constituted with only a quorum present, every eligible judge should sit." 40 N.Y.U.L.R. 739 (1965)

Uniform appellate procedure for original hearings of en banc cases ought to at least accord a statutory quorum of the active judges an opportunity to participate in the traditional phases of an appeal. The Second Circuit has created a hybrid "panel-en banc" procedure not contemplated by the statute.

It is anomalous for the Second Circuit to limit oral argument to a minority of the active judges on the original hearing en banc when the controlling statute, Section 46(c), requires a majority of the active judges to order the case en banc (Add. infra 1).

In view of the Second Circuit's rule 27(a) which accords litigants the right to orally argue motions seeking substantive relief, it is singularly inconsistent judicial administration for the same court to deny oral argument before a statutory quorum of the court in a case deemed important enough for en banc consideration.

Lest crowded calendars lead Circuit Courts to unwarranted emasculation of Section 46(c) and (d) in original hearings en banc, this Court ought to review the procedural questions presented.

II

THE EQUAL PROTECTION AND DUE PROCESS PROVISIONS OF THE FIFTH AMENDMENT WERE VIOLATED IN HOLDING THAT PETITIONER HAD VIOLATED SECTION 10(b) AND RULE 10(b)-5.

On its face Rule 10(b)-5 gives no indication that the purchase by a corporate employee of company stock following release of a company prepared and authorized announcement by a responsible government official of material information can be a violation of Rule 10(b)-5. (App B238a)

If Congress were to pass a law with criminal penalties making it unlawful for a corporate employee to trade in his company's stock for an indefinite time following disclosure of material information by his company this court would have sound reason and ample precedent for declaring such a law unconstitutional as a violation of the Fifth Amendment. McBoyle v. U.S. 283 U.S. 25 (1931)

The due process requirement of the Constitution requires clarity in a statute or regulation which carries criminal penalties, Lanzetta v. New Jersey, 306 U.S. 451, 453 (1939).

Even if criminal penalties are not sought in a particular case it is well established that the statute must nevertheless meet these standards. FCC v. American Broadcasting Co. 347 U.S. 284, (1954).

This court there said:

"It is true, as contended by the Commission that these are not criminal cases, but it is a criminal statute

> that we must interpret. There cannot be one construction for the Federal Communications Commission and another for the Department of Justice." Id at 296

According to the District Judge Section 3 of Rule 10(b)-5 was the only section of Rule 10(b)-5 applicable to the facts of petitioner's case for he found:

> "There was no evidence, however, that the defendants employed 'any device, scheme or artifice to defraud' under section (1) or made any representations under section (2). Therefore, only section (3) is applicable to the facts of this case." (App A60a n 7)

It is impossible to know from the language of Section (3) that following release of a company prepared and authorized announcement by a responsible government official of material information that purchase by a corporate officer of stock in his company during an indefinite period of time would violate that section. (App B238a)

The District Judge found that petitioner did not violate the plain language of Section (3) of Rule 10(b)-5 for he specifically stated:

> "...there is no evidence that Crawford intended to deceive or to defraud anyone..." (App A40a)

Even assuming its constitutionality, how then did petitioner violate Rule 10(b)-5? In what respect was petitioner's conduct manipulative or deceptive?

The error of construing Rule 10(b)-5 to proscribe mere purchases by a company officer without any showing of fraud or deceit is emphasized by a review of the legislative history which discloses that Section 16b of the Securities Act was intended to fully cover at all times such purchases by insiders on National Exchanges.

Thomas Corcoran, one of the leading draftsman of the 1934 Act, testified before the House Committee on Interstate and Foreign Commerce:

> "Well, all we have said to the director, sir, is that he cannot sell your own stock short, or make a turn in his own stock within 6 months." Hearings on H.R. 7852 and H.R. 8720 before the House Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 135 (1934).

Mr. Corcoran also indicated that Section 10(b) was:

> "...a catch-all clause to prevent manipulative devices. I do not think there is any objection to that kind of clause. The Commission should have the authority to deal with new manipulative devices." Id at 115

The placing of an order by petitioner to purchase his company stock when he believed the news of his company's discovery had been made public, was not a "new manipulative device."

Since Congress specifically limited Section 16 to requiring insiders to report their trades, not reverse their transactions within six months and forbade short sales, the Second Circuit has violated the principle enunciated by Mr. Justice Marshall in the New York Times - Washington Post cases that the Judicial Branch ought not aid and abet the Executive Branch in achieving a legal result specifically rejected by Congress.

Mr. Justice Marshall there stated:

> "It would however, be utterly inconsistent with the concept of separation of power for the Court to use its power of contempt to prevent behavior that Congress has specifically declined to prohibit." New York Times Company, Petitioner v. United States. 39 U.S.L.W. 4879 June 30, 1971

Yet that is the result reached by the lower courts with respect to petitioner and it ought to be reviewed.

III

THE EQUAL PROTECTION AND DUE PROCESS PROVISIONS OF THE FIFTH AMENDMENT WERE VIOLATED BY ENJOINING PETITIONER PURSUANT TO SECTION 10(b) AND RULE 10(b)-5.

A key phrase in the permanent injunction imposed on petitioner is "undisclosed material information." (App A216a) Lower court interpretations of "material" and "disclosed" are so numerous, so vague and so subjective that it is inequitable and unconstitutional to place petitioner in perpetual jeopardy of contempt of court if he does not correctly anticipate a Court's hindsight interpretation of those words. In commenting on disclosure and related Section 10(b) and Rule 10(b)-5 problems, Williston on Contracts says:

> "...the Commission has not formulated any standards on timely and proper disclosure, nor has it adopted any rules with respect to permissible action by 'insiders' after disclosure; and the court decisions, as indicated below, have left the matter in utter confusion." 3rd. Edition Section 1533-B, p. 716.

In this case of first impression the District Judge and the presiding Circuit Judge have by their own admissions sentenced petitioner for life to comply with unascertainable standards.

The District Judge was not fully conversant with the law of disclosure for he ruled that after an announcement was handed to the press, insiders could trade in the shares of their company. (App A43a-44a).

The District Judge analyzed the flaws in any disclosure rule requiring an indefinite waiting period before insiders were free to trade and concluded:

> "This could only lead to uncertainty... No insider would know whether he had waited long enough after an announcement had been made...The Commission has not supplied, nor has the Court found, decisions specifying a waiting period after a corporate announcement is made... If a waiting period is to be fixed, this could be most appropriately done by the Commission..." (App. A 43a-44a).

Reversing the District Court the Second Circuit held that there should be a period after an announcement during which time insiders could not trade. However, the Second Circuit also recognized that this was an area in which the SEC had failed to carry out its rule-making function saying:

> "...the permissible timing of insider transactions after disclosures of various sorts is one of the many areas of expertise for appropriate exercise of the SEC's rule-making power, which we hope will be utilized in the future to provide some predictability of certainty for the business community" (App.A97 a n 18).

Petitioner is placed in perpetual jeopardy of being held in contempt of court where there are no perceptible guidelines. This is not only inequitable, it is unconstitutional.

This court should also review the injunction of petitioner for it denies him equal

protection of the law guaranteed by the Fifth Amendment in that he is barred from conveying his property for indefinite periods of time during which time others are free to convey identical property. Shapiro v. Thompson 394 U.S. 618 (1969).

IV

PETITIONER DID NOT VIOLATE SECTION 10(b) AND RULE 10(b)-5 SINCE HIS CONDUCT WAS NOT MANIPULATIVE OR DECEPTIVE.

Section 10(b) makes unlawful the use of "any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe ..." (App. B 236a).

There has been no evidence or contention that petitioner's purchase deceived or might have tended to deceive anyone or that such purchase manipulated or might have tended to manipulate anything. No seller of stock was caused to sell or otherwise affected by the purchase or other conduct of petitioner. Hence his conduct was not "deceptive" or "manipulative."

Petitioner asks this court to decide whether Section 10(b) and Rule 10(b)-5 can be violated by conduct which is not "manipulative" or "deceptive"? The majority below assert that, by the Exchange Act, "...Congress purposed to prevent inequitable and unfair practices and to insure fairness in securities transactions generally..." and

that Rule 10(b)-5 "...is based in policy on the justifiable expectation of the securities market place that all investors trading on impersonal exchanges have relatively equal access to material information ..." (App. A 85 a).

In effect, the court below holds that §10(b) proscribes not only the conduct the section refers to, i.e., that which is "deceptive" or "manipulative," but also certain conditions which may characterize a market place, e.g., those which a court may consider "unfair." Since petitioner's purchase did not harm or otherwise affect any seller, his conduct was not unfair to anyone.

V

IN PETITIONER'S CASE AN INEQUITABLE RESULT HAS BEEN REACHED IN THE NAME OF EQUITY.

1. Especially in a case of first impression, equitable remedies should be based on equal treatment. In not enjoining other defendants found to have violated Section 10(b) and Rule 10(b)-5 the District Judge assigned as reasons:

> "The record makes it clear that the discovery on the Kidd 55 segment was a once-in-a-lifetime affair."
>
> * * *
>
> "the violations occurred more than five years ago..."
>
> * * *
>
> "...there is no evidence that any of these defendants have been guilty of further violations."
>
> * * *

"It is believed that the wide publicity accorded to these defendants will serve as an adequate deterrent, when coupled with the fact that none of these defendants will retain the profits which they realized by reason of their violations."

* * *

"...the reporting requirements of the 1934 Act..."

* * *

"...but they, (i.e. other defendants) as indeed all insiders, are now on notice of the scope of Section 10(b) and Rule 10(b)-5." (App A196a)

Since all these reasons are equally applicable to petitioner, singling out petitioner for an injunction for life is most inequitable.

In setting aside a suspension order of only four months duration imposed by the SEC on a broker, the Court of Appeals for the Sixth Circuit assigned as reasons the passage of time since the violation had occurred, about the same time as in petitioner's case, and the fact that there had been no violation since the act complained of. Beck v. SEC 430 F. 2d 673 (6th Cir. 1970). The Court of Appeals concluded: "...the Commission's order is punitive, not remedial." Id at 674.

This is a case of first impression for at the time petitioner purchased his shares, no court had held that Section 10 (b) or Rule 10(b)-5 applied to a stock exchange transaction such as was involved here and petitioner testified without challenge that he knew of no law or regulation proscribing his action:

Q. "When you bought those shares, Mr. Crawford, did you know of any statute, rule of the SEC or the Stock Exchange or of any court which made it illegal or improper for you to make those purchases"?

A. "I did not." (316JA)

If petitioner had been trying to beat the news he could have purchased his company's stock the afternoon of April 15. The reasonableness and good faith of the petitioner's belief that an announcement by Mr. Wardrope, the Minister of Mines, prepared and authorized by the company (Add. infra, 5) would be in the public domain before his purchase could be acted upon is borne out by the District Court which specifically found with respect to the Minister of Mines announcement:

> "The effect of the foregoing was that before the market opened on April 16, some brokers and some speculators had picked up information that TGS had made an ore discovery." (App. A 36a)

2. The injunction imposed upon the petitioner is a punishment not a deterrent.

This Court has said:

> "The historic injunctive process was designed to deter not to punish." Hecht Co. v. Bowles 321 U.S. 321, 329 (1944).

Throughout these proceedings the SEC has emphasized their equitable nature in order to lighten its burden of proof in seeking the "mild prophylactic" of an injunction: However from the outset SEC counsel cast the petitioner and other defendants in the role of miscreants deserving punishment:

> "The Commission's objective in bringing these proceedings before the court are to drag to light and pillory the misconduct of the individual defendants." (283JA)

SEC's Rule 2(e) provides that petitioner by virtue of having violated the statute or having been enjoined by name in this proceeding can be suspended from appearing or practicing before it. (Add infra, 3). This is not a deterrent, it is a punishment.

For a respected member of the legal profession for thirty years to be found to have violated a Federal Statute is stigma enough for one lifetime. But to add to that an injunction for life is doubly degrading since the only inference is that unless an injunction is imposed the petitioner is likely to violate the rule again.

In its attempt to make new law respondent would destroy traditional law and petitioner too.

Such a case merits this court's review.

VI

ADOPTION OF ARGUMENTS CONTAINED IN COMPANION PETITIONS FILED IN THIS CASE.

Petitioner has read the petitions to be filed with this Court by White & Case; Keane, Butler & Grean, and Earl L. Huntington and respectfully adopts by reference the questions presented in those petitions and their reasons and arguments for soliciting this Court's review.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari ought to be granted.

Respectfully submitted,

David M. Crawford
Pro se

September 8, 1971

ADDENDUM 1

Court of Appeals for the Second Circuit Order of May 2, 1968

"Upon motion of the active circuit judges, it is ordered that the appeal be considered in banc by all the active judges of the court upon the record and the briefs heretofore filed, and the opinions written by the judges who heard the argument of the appeal, without further argument."

28 USCA §46 - Assignment of judges; divisions; hearings; quorum

(c) Cases and controversies shall be heard and determined by a court or division of not more than three judges, unless a hearing or rehearing before the court in banc is ordered by a majority of the circuit judges of the circuit who are in regular active service. A court in banc shall consist of all circuit judges in regular active service. A circuit judge of the circuit who has retired from regular active service shall also be competent to sit as a judge of the court in banc in the rehearing of a case or controversy if he sat in the court or division at the original hearing thereof.

(d) A majority of the number of judges authorized to constitute a court or division thereof, as provided in paragraph (c), shall constitute a quorum.

ADDENDUM 2

Federal Rules of Appellate Procedure
Rule 35(a) and Rule 40(a)

Determination of Causes by the Court In Banc

35(a) When Hearing or Rehearing In Banc Will be Ordered. A majority of the circuit judges who are in regular active service may order that an appeal or other proceeding be heard or reheard by the court of appeals in banc. Such a hearing or rehearing is not favored and ordinarily will not be ordered except (1) when consideration by the full court is necessary to secure or maintain uniformity of its decisions, or (2) when the proceeding involves a question of exceptional importance.

Petition for Rehearing

40(a) Time for Filing; Content; Answers; Action by Court if Granted. A petition for rehearing may be filed within 14 days after entry of judgment unless the time is shortened or enlarged by order. The petition shall state with particularity the points of law or fact which in the opinion of the petitioner the court has overlooked or misapprehended and shall contain such argument in support of the petition as the petitioner desires to present. Oral argument in support of the petition will not be permitted. No answer to a petition for rehearing will be received unless requested by the Court, but a petition for rehearing will ordinarily not be granted in the absence of such a request. If a petition for rehearing is granted the court may make a final disposition of the cause without reargument or may restore it to the calendar for reargument or resubmission or may make such other orders as are deemed appropriate under the circumstances of the particular case.

ADDENDUM 3

SEC Rule 2e

(3)(i)The Commission, with due regard to the public interest and without preliminary hearing, may by order temporarily suspend from appearing or practicing before it any attorney, accountant, engineer or other professional or expert who, on or after July 1, 1971, has been by name

(A) permanently enjoined by any court of competent jurisdiction by reason of his misconduct in an action brought by the Commission from violation or aiding and abetting the violation of any provision of the federal securities laws (15 U.S.C. §§77a-80b-20) or of the rules and regulations thereunder; or

(B) found by any court of competent jurisdiction in an action brought by the Commission to which he is a party or found by this Commission in any administrative proceeding to which he is a party to have violated or aided and abetted the violation of any provision of the federal securities laws (15 U.S.C. §§77a-80b-20) or of the rules and regulations thereunder (unless the violation was found not to have been willful).

ADDENDUM 4

Footnote at Page 12 of Petition for Rehearing September 20, 1968

"The important and complex issues in this litigation have been determined by the entire court en banc. Six of the nine judges have cast their votes on the cold record and briefs, without oral argument. With great respect we suggest that issues as important as these should not be decided without the revealing interchange between court and counsel that usually accompanies oral argument. Indeed, there is substantial question whether the parties have in fact been "heard" as required by the statute (28 U.S.C. §46(c)). See the opinion of Jones, J. in Reynolds Aluminum Company v. NLRB, 394 F. 2d 405, 409 (5th Circuit 1968)."

241c
ADDENDUM 5

PX. 73

Handwritten draft release

BON AIR
MOTOR INN LIMITED — KIRKLAND LAKE, ONT.
MOTEL LTD. — TIMMINS, ONTARIO

To

Mr. Wardrope Release-4-15-64
11 PM

There have been rumors during the past few weeks about the exploration work of TGS North of Timmins, Ontario in Kidd Township. Until only ten days ago TGS had only one diamond drill operating, & there really was not much basis for the rumors. A second machine began operating on April 6, but only part time because extremely cold weather restricted the amount of water available for drilling. With the warmer weather of the past week, water was more easily found, so that a third drill was started on April 10, & a fourth on April 12. This intensification of work in the last few days has resulted in a rapid accumulation of significantly more data than the company had as recently as this past weekend.

There are still only six drill holes complete enough to be important in evaluating the sulphide body being explored, & actual assays from only one hole, but the information now in hand from this limited work gives the company confidence to allow me to announce that TGS has a mineable body of Zn, Cu, Ag ore of substantial dimensions that will be developed & brought to production as rapidly as possible.
(Emphasis Added)

ADDENDUM 6

Richard D. Mollison—for Plaintiff—Direct

(1000) Q. Mr. Mollison, turning now to the Canadian Minister of Mines and the circumstances under which he made a certain announcement with respect to the Kidd 55 discovery, what arrangements did you make with Mr. Wardrope, the Minister of Mines, in that connection? A. We met Mr. Wardrope and Mr. Douglas, Dr. Holyk and I, on the morning of April 15th at the Montreal airport and flew with them back to Toronto. On the way we discussed with them the progress of our work until that time. We showed them our sections, location maps, such assays as we had, in an effort to give them a fairly complete picture.

My recollection is that their response was complex, but perhaps in one way it was a welcome to us. They were happy that we had found something. They wanted to make some statement about it from the Department. This would be something that the Mines Minister would put out.

(1001) In response to that request I wrote out a brief statement which I handed to Mr. Wardrope.

His plans for that day were fairly busy. I don't recall the details, but the general situation was that he had a dinner and I think a speaking engagement that evening, but he expected to be—and just outside of Toronto somewhere. He expected to be back in Toronto that evening so that he could make an announcement, presumably, radio and T.V, or at least one of them, at 11 o'clock.

So I wrote out a statement and I marked it "For 11 o'clock" that night.

Q. Is this the statement that you wrote out, Mr. Mollison, Plaintiff's Exhibit 73 (handing)? A. This is similar to the one I wrote out. This is the first one I wrote out, and I made a couple of corrections and then I rewrote it without the corrections. Otherwise, as I recall, it is the same as this, and he took the other one with him.

ADDENDUM 7

David M. Crawford—for Plaintiff—Cross

Q. Tell us again what Dr. Fogarty said about this release, Mr. Crawford. Did he say when it was going to be delivered and by whom and where? (105) A. He told me

David M. Crawford—for Plaintiff—Cross

that the Minister of Mines, Mr. Wardrope, was going to make that announcement over TV and radio in Canada at 11 o'clock, New York time, that night.

Q. And he asked you to call the Texas Gulf managers in Canada to alert them to the making of this announcement at 11 p.m. on that evening? A. He did.

Q. And did you? A. I did. I called our manager of exploration in Calgary and read him the text of that release.

Q. The complete text of this release? A. I did.

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In the Supreme Court of the United States

OCTOBER TERM, 1971

Nos. 71-327, -328, -346, -347

TEXAS GULF SULPHUR COMPANY, ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

EARL L. HUNTINGTON, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

DAVID M. CRAWFORD, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

WALTER HOLYK, ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 220a-233a) is reported at 446 F. 2d 1301. The opinion

of the district court (Pet. App. 175a–214a)[1] is reported at 312 F. 2d 77. The prior opinions of the court of appeals (Pet. App. 66a–171a) and the district court (Pet. App. 1a–63a) are reported respectively at 401 F. 2d 833 and 258 F. Supp. 262.

JURISDICTION

The judgment of the court of appeals was entered on June 10, 1971 (Pet. App. 220a).[2] The petitions for writs of certiorari were filed on September 3, 1971, and September 8, 1971. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1). Because petitioners' notice of appeal to the court of appeals may have been a nullity (see n. 3 *infra*), there may be a question as to the jurisdiction of this Court.

QUESTIONS PRESENTED

1. Whether Rule 10b–5 of the Securities and Exchange Commission, which proscribes activities operating as a fraud or deceit upon any person in connection with the purchase or sale of securities, validly outlaws

(a) the issuance without due care of a materially misleading corporate press release reasonably calculated to influence the investing public;

(b) trading by insiders in securities of their corporation on the basis of undisclosed material facts and

[1] "Pet. App." refers to petitioners' appendix in No. 71–327.

[2] The prior judgment of the court of appeals was entered on August 13, 1968. Petitioners filed a petition for rehearing on September 20, 1968, which was denied on October 7, 1968. Separate petitions for certiorari were filed by Harold B. Kline, who once again seeks review in No. 71–327, and by Francis G. Coates. Both petitions were denied. 394 U.S. 976.

the giving of tips for others to trade on the basis of such facts; and

(c) the acceptance by top corporate officials of stock options without disclosing to the corporate directors granting such options material nonpublic information affecting the market value of the corporation's stock.

2. Whether a press release issued by petitioner Texas Gulf Sulphur Company to deny newspaper stories respecting a rumored ore discovery by Texas Gulf was materially misleading and issued without due care.

3. Whether information respecting Texas Gulf's drilling into what proved to be a remarkably rich deposit of copper, zinc, and silver ore was material information that should have been disclosed when insiders of the company purchased its stock, gave tips or accepted stock options.

4. Whether the court of appeals properly held that the district court did not abuse its discretion in enjoining the commission of future similar violations by certain insiders of Texas Gulf who had purchased its stock "knowing beyond peradventure of a doubt that [Texas Gulf] had made a very important mineral discovery" that had not been disclosed.

5. Whether Section 27 of the Securities Exchange Act, granting the district court jurisdiction over violations of the Act and over all suits in equity to enforce any liability or duty created by the Act, authorized the district court, in an injunction action brought by the Commission, to direct that the profits resulting from violations of the Act be given up, both

by violators who are enjoined and by those who are not enjoined.

6. Whether a court of appeals can decide a case *en banc* when only a three-judge panel has heard oral argument and, if not, whether the precedure can be attacked by parties who failed to object when the court announced that it intended to follow such procedure.

STATUTE AND RULE INVOLVED

Sections 10(b), 21(e) and 27 of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), 78u(e) and 78aa, and Rule 10b–5 of the Commission, 17 CFR 240.10b–5, are set out at Pet. App. 235a–239a.

STATEMENT

This action arises out of "a major strike of zinc, copper and silver * * *" (Pet. App. 40a) by Texas Gulf Sulphur Company ("Texas Gulf") on land located near Timmins, Ontario, Canada. The exploratory drilling that preceded a news release distributed at a press conference announcing this discovery on April 16, 1964, was carried out by Texas Gulf in the preceding five-month period (Pet. App. 1a). The courts below found that, prior to sufficient dissemination of this announcement to the public, ten officers, directors and employees of Texas Gulf, who possessed various degrees of information about the results of the drilling at various stages in the exploration, all engaged in securities transactions in violation of Section

10(b) of the Securities Exchange Act and the Commission's Rule 10b–5.

The court of appeals affirmed the judgment entered April 16, 1970, against six of the nine individual petitioners: Harold B. Kline, vice president and general counsel; David M. Crawford, secretary; Walter Holyk, chief geologist; Earl L. Huntington, attorney; Richard Clayton, engineer, and Kenneth H. Darke, geologist; no judgment was entered against petitioners Claude O. Stephens, president and director, Charles F. Fogarty, executive vice president and director, or Richard D. Mollison, vice president-exploration.[3] The court

[3] One of the defendants, Francis G. Coates, a director of Texas Gulf, consented to entry of a judgment against him on October 2, 1969, pursuant to a stipulation with the Commission (R. 6412–6420).

On June 22, 1970, a default judgment was entered against another defendant, Thomas P. O'Neill, an accountant who had been employed by Texas Gulf. Petitioners' notice of appeal, which was filed on June 15, 1970, preceded the entry of the default judgment. Since there had not been, as Rule 54(b) of the Federal Rules of Civil Procedure specifies, an "express determination that there [was] no just reason for delay" and there had been no "express direction for the entry of judgment," the order petitioners appealed from, entered on April 16, 1970, appears not to have been a final judgment that is appealable. *Davis* v. *National Mortgage Corp.*, 320 F. 2d 90 (C.A. 2); *G.W.K., Inc.*, v. *Philco Corp.*, 276 F. 2d 928 (C.A. 2); *Partin* v. *Hassan Motors, Inc.*, 363 F. 2d 104 (C.A. 6). See also *Advisory Committee Notes on Rule 54(b)* (1961 Amendments). A premature notice of appeal has been held to be a nullity and without effect. *Studer* v. *Moore*, 153 F. 2d 902, 903 (C.A. 2); *Stevens* v. *Turner*, 222 F. 2d 352 (C.A. 7); *Aberlin* v. *Zisman*, 244 F. 2d 620 (C.A. 1), certiorari denied, 355 U.S. 857. The Commission, without urging dismissal on this ground, brought these facts and authorities to the attention of the court below, which did not comment thereon.

of appeals also held that petitioner Texas Gulf violated Section 10(b) and Rule 10b–5 by failing to exercise due diligence in issuing a misleading press release on April 12, 1964, denying rumors of a "major strike" only four days before the ore strike was formally announced. No judgment was entered against Texas Gulf.

1. THE COMMISSION'S COMPLAINT

On April 19, 1965, the Commission filed a complaint (JA 77a–115a)[4] in the district court alleging that, during the exploratory drilling and before the information contained in the April 16 press release became available to the public, thirteen officers, directors and employees of Texas Gulf, including petitioners, had each committed one or more of the following violations of Section 10(b) and Rule 10b–5:

> 1. Purchased Texas Gulf common stock or calls on that stock on the basis of the results of the drilling without appropriate disclosure.
>
> 2. Divulged information as to drilling results to friends, relatives or business associates for use in their purchases, without appropriate disclosure, of Texas Gulf stock or calls or recommended on the basis of such inside information that they purchase Texas Gulf securities.
>
> 3. Accepted stock options from Texas Gulf while this information as to drilling results was concealed from Texas Gulf's directors.

It also alleged that Texas Gulf had violated Section 10(b) and Rule 10b–5 by the issuance on April 12,

[4] "JA" refers to the joint appendix in the court of appeals, a copy of which has been lodged in this Court.

1964, of a false and misleading press release about the ore deposit.

The complaint requested that the defendants be permanently enjoined from future similar violations of Section 10(b) and Rule 10b–5; that the individual defendants who had violated those provisions by purchasing Texas Gulf stock or calls be required to offer rescission to the sellers; that those who had divulged such information be required to offer restitution to stockholders who had sold Texas Gulf securities to the recipients of the information; and that stock options accepted by the defendants be rescinded (JA 113–115).

2. THE EVIDENCE RELEVANT TO PETITIONERS

In 1963, Texas Gulf was a narrowly-based company deriving 97 per cent of its income from sulphur (JA 1222a). Because of an over-supply of sulphur on the world market, Texas Gulf's sales and earnings had declined from 1955 to 1963, and Texas Gulf was endeavoring to deal with its depressed business by diversifying into related fields. One aspect of this diversification was an exploratory program for base metal sulphides in Canada.[5] (Pet. App. 2a–5a), which, if successful, would open a new area of corporate opportunity for the company (JA 1060a). Up to November 1963, however, the corporation had spent six years and millions of dollars in exploring more than 15,000 square miles of eastern Canada without success (Pet. App. 5a, 8a; JA 1723a).

[5] Sulphides are chemical combinations of sulphur with other elements (Pet. App. 59a n. 2).

Texas Gulf had an option to purchase the northeast quarter section of a square-mile plot of land located near Timmins, Ontario called the Kidd 55 segment (Pet. App. 6a). It had obtained the option after conducting an aerial geophysical survey, confirmed by subsequent geophysical investigations on the ground, indicating the existence of a wide "first class" anomaly [6] measuring some 1000 feet in length (Pet. App. 6a, 8a, 29a).

On November 8 through 12, 1963, Texas Gulf drilled an exploratory drill hole, K–55–1, on this section (Pet. App. 8a). Although the anomaly could have been caused by worthless materials (Pet. App. 59a n. 3), a visual examination of the core recovered from the hole revealed such high copper and zinc values over a length so great—approximately 600 consecutive feet of the core's 657-foot length (Pet. App. 27a–28a)—that four expert witnesses called by petitioners testified they had never seen or heard of a comparable initial exploratory drill hole in a base metal mineral deposit (Pet. App. 76a). Moreover, the mineralization began only 26 feet below the surface of the earth. This drill hole has been described as "one of the most impressive drill holes completed in modern times" (Pet. App. 90a n. 13) and "just beyond your wildest imagination" (Pet. App. 90a).

The "excited" company geologist, Mr. Darke, who had been at the drill site, called from Timmins to his superior Dr. Holyk at his home in Stamford, Connect-

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[6] An anomaly is a deviation from the normal in the earth's crust of such physical characteristics as electrical conductivity (R. 665).

icut, on Sunday evening, November 10, to report the initial intersection of copper mineralization (JA 723a–724a, 260a–261a). Within two days this and subsequent reports from the drill site had brought Dr. Holyk, Mr. Mollison and Dr. Fogarty, senior officials of the corporation, from New York to Timmins under conditions of great personal discomfort. There they were able to compare the visual estimates of the mineralization in the core logged by Messrs. Holyk and Darke with the actual core (JA 719a, 723a–724a, 756a–758a, 848a–850a).

As a result of the information thus obtained by the top management of Texas Gulf, security measures were taken to keep the results of the drilling secret so that the corporation could acquire the remainder of the land at favorable prices (Pet. App. 8a–9a; JA 910a–911a, 245a). These measures included an order by Mr. Stephens, the president of the corporation, that no one outside the exploration group, not even the nonmanagement directors, should be told about the drilling results (Pet. App. 47a, 75a). Drilling was suspended and was not resumed until March 31, 1964 (Pet. App. 9a).

During the four and one-half months between November 12, 1963, when K–55–1 was completed, and March 31, 1964, when the drilling was resumed on the Kidd 55 segment, the individual defendants and certain other persons who received "tips" from them purchased Texas Gulf stock and calls thereon. Prior to these transactions "these persons had owned 1135 shares of TGS stock and possessed no calls; there-

after they owned 8235 shares and possessed 12,300 calls" (Pet. App. 76a).[7]

During this period Texas Gulf granted stock options covering 89,950 shares of Texas Gulf stock to officers and employees of the company, including options covering 30,700 shares to petitioners Stephens, Fogarty, Kline, Mollison and Holyk. Pursuant to the secrecy order of the corporation's president (see p. 9, *supra*), who had recommended the granting of the options, the news of Texas Gulf's discovery of copper and zinc in Timmins had been withheld from the members of the incentive stock option committee of the board of directors (JA 329a–330a, 332a–333a, 339a–341a, 362a), which met on February 20, 1964, and recommended the granting of the options (Pet. App. 46a). After the meeting of the committee there was a meeting of the full board, at which time the recommended options were formally granted (Pet. App. 46a). None of the nonmanagement directors knew about the drilling results (Pet. App. 63a n. 16). Mr. Kline, as administrative vice president and secretary, attended both the meeting of the committee and the meeting of the full board (Pet. App. 103a; JA 401a–402a). Although the options were intended to be granted at the fair market value of the underlying stock based upon its current market price (Pet. App. 48a), neither Stephens, Fogarty nor Kline informed the committee or board about the drilling results.

Drilling on the Kidd segment was resumed by Texas Gulf on March 31, 1964, and by Friday, April 10, 1964,

[7] Individual purchases are set forth in chronological order at Pet. App. 70a–71a.

"approximately ⅔ of the ore ultimately found to exist by the time of the preparation of the April 16, 'major strike' release had been discovered by 5 holes placed so as to indicate continuity of mineralization within the large anomaly" (Pet. App. 114a n. 28). By 7:00 a.m. on Monday, April 13, 1964, when Texas Gulf's "gloomy" press release appeared in New York City newspapers (Pet. App. 58a), all but one of the seven holes upon which Texas Gulf based its April 16 announcement that it had made a "major strike" had either been completed or had already encountered mineralization (Pet. App. 8a–12a).[8]

The "gloomy" press release was "designed to quell the rumors" reported in New York newspapers on Saturday, April 11, 1964, respecting the ore discovery by Texas Gulf (Pet. App. 78a). On that day Dr. Fogarty conferred with Mr. Mollison, who had left Timmins the preceding day and returned to his home in Connecticut, and who advised Dr. Fogarty of the drilling results as of 7:00 p.m. April 10 (Pet. App. 53a). On Sunday, April 12, 1964, after the release had been drafted for Monday morning publication, Dr. Fogarty again called Mr. Mollison to see if he had any further information and was told that he did not (Pet. App. 54a). Despite the rapidly developing situation at Timmins (Pet. App. 10a–11a, 59a n. 4), the draftsmen of the release made no effort to determine what had happened at the drill site between Friday evening and

[8] The mineralization encountered by these six holes as of that time amounted to 90 percent of the mineralization announced in the April 16 press release (Pet. App. 114a n. 28).

Sunday afternoon.[9] Dr. Fogarty, the principal draftsman of the release, admitted that he did not want "to take that trouble" to obtain such information (J.A. 863a).

Notwithstanding the fact that none of the "drilling results after 7:00 p.m. on April 10 were known to the framers of the April 12 release" (Pet. App. 57a), the release (Pet. App. 177a–178a), which was issued Sunday afternoon and designed to appear in Monday's papers, spoke in terms of "[t]he drilling done to date" and "work done to date." It labeled the rumors of an ore discovery as "exaggerate[d]" and "without factual basis"; it indicated that any statements about size and grade of ore were "premature and possibly misleading"; it labeled the Kidd 55 segment a "prospect" and indicated that "more drilling would be required for proper evaluation * * *." The release did not give any facts concerning the amount of drilling done nor the results of such drilling.

Stories reflecting the release appeared in the *Wall Street Journal* and other news media on Monday, April 13, 1964, as well as on the Dow Jones broad tape (Pet. App. 188a).[10] The price of Texas Gulf common

[9] There were no problems with respect to telephone communication between New York and Timmins (JA 774a), and both Messrs. Darke and Clayton were in Timmins on April 12 (Pet. App. 37a; JA 731a).

[10] On the morning of April 13, the day the press release was disseminated to the investing public, Mr. Ackerley, a reporter for *The Northern Miner*, visited the drill site, where Messrs. Mollison, Holyk and Darke were present. Based entirely on the information obtained that morning (Pet. App. 56a; JA 833a–834a), Mr. Ackerley wrote an article that appeared in *The*

stock on the New York Stock Exchange, which had shown a steady rise from $16 a share in November 1963 to $32 a share when it opened on the Exchange on April 13, 1964, closed at 30⅞, and continued to decline in price on April 14 and 15 (Pet. App. 83a).

On the afternoon of April 15, the top management of Texas Gulf decided to hold a press conference the next morning, following a regularly scheduled meeting of the board of directors, to announce the discovery (JA 867a–868a).[11] This method of announcing the major ore discovery was chosen "to get the information to the most stockholders as quickly as it was possible," and because the board considered a press conference to be "the best media [sic] to get maximum coverage to everyone at the same time." (JA 869a–870a). Following the news of the discovery, on substantially increased trading, the price of Texas Gulf common stock on the Exchange closed on April 16, 1964, at 36⅜, seven points over its close of the previous day. By mid-May the stock was trading at more than $58 a share (Pet. App. 83a).

During the period of drilling activity from March 31, 1964, to April 16, 1964, defendants purchased an additional 1860 shares of Texas Gulf stock (Pet. App. 70a). Among these purchases were those made by Messrs. Crawford and Clayton "within 24

Northern Miner on April 16, 1964, which stated that "a major new zinc-copper-silver mine is definitely in the making * * *" and mentioned an indicated ore reserve of more than 10 million tons (Pet. App. 82a, 34a–35a).

[11] This was the first time in at least 14 years that a Texas Gulf directors' meeting was to be followed by a press conference (JA 869a, 847a).

hours before the news of the ore strike was made public" on April 16 (Pet. App. 225a). At the time of their purchases both were aware of the April 12 press release (Pet. App. 39a, 101a) and both knew "beyond peradventure of a doubt" that Texas Gulf "had made a very important mineral discovery" (Pet. App. 197a).

3. THE JUDICIAL DECISIONS

A. THE INITIAL DECISIONS OF THE DISTRICT COURT AND THE COURT OF APPEALS: THE VIOLATIONS [12]

The district court and all the judges of the court of appeals sitting *en banc* agreed that Section 10(b) and Rule 10b–5 prohibit corporate insiders from purchasing their corporation's securities or calls thereon on a national securities exchange when the purchases are made on the basis of material information about the corporation which is not available to the investing public (Pet. App. 20a–24a, 73a–74a, 119a, 128a, 170a). They also agreed that any member of top management who accepted a stock option from a corporation while withholding material information from the directors would also violate Section 10(b) and Rule 10b–5 (Pet. App. 48a–49a, 73a, 119a–121a, 128a, 146a–147a).[13] Furthermore, they agreed that in enforcement actions

[12] Pursuant to a stipulation by all parties the question of the appropriate remedy was deferred pending the initial appeal; therefore the first round of decisions by the district court and the court of appeals dealt with the question whether violations of the Securities Exchange Act had occurred.

[13] Both courts apparently recognized that in granting incentive stock options the directors of the company necessarily rely on information furnished to them by the top management of the corporation (Pet. App. 47a), and that the latter are there-

under Section 10(b) and Rule 10b–5 the Commission need not prove scienter or intent to deceive (Pet. App. 18a–20a, 99a–100a, 119a, 128a, 170a).

INSIDERS PURCHASING TEXAS GULF STOCK AND "TIPPING" OTHERS TO PURCHASE

The district court held that the persons who had purchased stock or calls or had recommended purchase of Texas Gulf stock to others prior to 7:00 p.m. on April 9, 1964, when the court found that there was "real evidence that a body of commercially mineable ore might exist" (Pet. App. 28a–29a), did not violate Rule 10b–5 because in its view the drilling results had not been material up to that time (Pet. App. 33a–34a). While the district judge found that "[t]here was no doubt that the [first] drill core * * * was unusually good and that it excited the interest and speculation of those who knew about it" (Pet. App. 29a), he believed that "* * * the test of materiality must necessarily be a conservative one * * *" and that only long-term, conservative investors were protected against misuse of inside information (Pet. App. 25a–26a). Only Messrs. Clayton and Crawford, who had purchased or placed orders to purchase Texas Gulf securities just prior to the April 16 announcement of a "major strike", were found to have violated Section 10(b) and Rule 10b–5.

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fore "under a duty to inform * * * [them] of material information affecting the issuance of the stock options," including "material information bearing on the market value of * * * [the] stock on that date" (Pet. App. 48a). There were, however, some differences of opinion as to when disclosure would be appropriate (Pet. App. 103a n. 24, 119a–121a, 146a–147a).

The court of appeals, while relying on the trial court's "findings of basic fact" (Pet. App. 89a), rejected that court's "conservative" (Pet. App. 87a–88a) standard of materiality. In determining whether the facts involved here were material, it noted two alternative phrasings of the standard of materiality applicable in Rule 10b–5 cases: "'* * * whether a *reasonable* man would attach importance * * * [to the information] in determining his choice of action in the transaction in question,' " and whether " '* * * in reasonable and objective contemplation [the information] *might* affect the value of the corporation's stock or securities * * *' " (Pet. App. 87a, emphasis in original). It held that all investors, including those with speculative objectives, are entitled to the protection of the Act (Pet. App. 88a), and it ruled that the information about the first drill core was material, since it "might well have affected the price of TGS stock and would certainly have been an important fact to a reasonable, if speculative, investor in deciding whether he should buy, sell, or hold" (Pet. App. 89a).[14]

[14] The court criticized the trial court for disregarding "the only truly objective evidence of the materiality of the K–55–1 discovery"—"the importance attached to the drilling results by those who knew about it" and their "insider trading activity" (Pet. App. 91a). It concluded that "the timing by those who knew of it of their stock purchases and their purchases of *short-term* calls—purchases in some cases by individuals who had never before purchased calls or even TGS stock—virtually compels the inference that the insiders were influenced by the drilling results." The trial court had "made no finding that the insiders were motivated by any factor other than the extraordinary K–55–1 discovery when they bought their stock and their

Accordingly, the court of appeals reversed the district court, holding that those insiders who had purchased Texas Gulf stock or calls thereon, or who had "tipped" others to purchase Texas Gulf stock [15] after November 12, 1963, were in possession of material inside information and therefore, having failed to disclose that information, were in violation of Section 10(b) and Rule 10b–5 (Pet. App. 73a–74a). The court remanded the case to the district court to determine the appropriate remedy (*ibid.*). At the same time the court unanimously affirmed the district court's judgment with respect to Messrs. Crawford and Clayton, who had purchased Texas Gulf stock just prior to the April 16 release (Pet. App. 73a, 170a).

INSIDERS' ACCEPTANCE OF STOCK OPTIONS

With respect to those who received stock options, the district judge found no violations because he viewed the drilling results as not material by February 20, 1964, the date on which the options were granted (Pet.

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calls" but had relied "upon what these defense experts said the defendant insiders *ought* to have thought about the worth to TGS of the K–55–1 discovery." *Id.*

For example, Dr. Fogarty, who owned 705 shares of Texas Gulf stock before this period of time (JA 235a), purchased 300 shares of Texas Gulf stock on November 12, 1963, just before he left for Timmins to view the "remarkable" core for himself. (Pet. App. 13a; JA 850a). Following his return, he purchased 700 shares of Texas Gulf stock on November 15, 1963, and 500 shares on November 19, 1963 (Pet. App. 13a). On November 26, 1963, he purchased another 200 shares (Pet. App. 13a).

[15] All nine judges of the court of appeals appeared to agree that the practice of tipping is unlawful, although they differed as to the scope of the prohibition (Pet. App. 86a, 94a n. 16, 170a).

App. 49a). In addition, the court determined that Messrs. Kline, Mollison and Holyk were not members of top management and had no duty to inform the directors of information known by their superiors "since they could assume that such information would be reported" to them by Stephens and Fogarty, the company's top two officials (Pet. App. 48a).

The court of appeals reversed the district court with respect to Messrs. Stephens, Fogarty and Kline, holding that they violated Section 10(b) and Rule 10b-5 because they were in possession of material information when they accepted their stock options, and remanded the case for a determination of the appropriate remedy (Pet. App. 118a). In addition, with respect to Mr. Kline it decided that he was a member of top management [16] (Pet. App. 103a) and that, although he "had no detailed knowledge of the drilling progress * * *" (Pet. App. 102a), he violated his "duty before accepting his option to disclose any material information he may have possessed * * *" (Pet. App. 103a). Mr. Stephens and Dr. Fogarty had surrendered their options and these had been canceled by the company (Pet. App. 102a). The court of appeals on remand instructed the district court to direct rescission of the option granted to Mr. Kline (Pet. App. 118a).

TEXAS GULF'S APRIL 12, 1964, PRESS RELEASE

The trial court held that the press release was not issued "in connection with the purchase or sale of any

[16] The Commission did not appeal the trial court's determination that Messrs. Mollison and Holyk were not members of top management (Pet. App. 103a–104a).

security" within the meaning of Section 10(b) and Rule 10b–5 because there was no "showing that the purpose of the April 12 press release was to affect the market price of TGS stock to the advantage of TGS or its insiders * * *" (Pet. App. 54a). Alternatively, the court concluded that although the drilling results as of 7:00 p.m. April 9, 1964, were material, the press release, while perhaps "gloomy or incomplete," was not misleading or deceptive "on the basis of the facts then known" to Texas Gulf—the drilling results as of 7:00 p.m. April 10, 1964—(Pet. App. 58a). Moreover, without reference to the failure by the company to secure more up-to-date drilling information, the district court found that Messrs. Stephens and Fogarty had "exercised reasonable business judgment under the circumstances" in issuing the release on "the facts then known" (Pet. App. 58a).

Reversing the district court, the court of appeals held that the "in connection with" requirement in Section 10(b) and the Rule is satisfied when "* * * the device employed * * * be of a sort that would cause reasonable investors to rely thereon, and, in connection therewith, so relying, cause them to purchase or sell a corporation's securities" (Pet. App. 109a). It further determined that the Commission, which was "charged by Congress with the responsibility of policing all misleading corporate statements" (Pet. App. 111a), need not show that the corporation or those responsible for the corporate statements "engaged in related securities transactions or otherwise acted with wrongful motives" (Pet. App. 109a). To read such a

requirement into the statute it concluded would "render the Congressional purposes ineffective" and "handicap unreasonably the Commission in its work" (Pet. App. 111a). Accordingly, it held (Pet. App. 113a) that

> * * * Rule 10b–5 is violated whenever assertions are made, as here, in a manner reasonably calculated to influence the investing public, e.g., by means of the financial media * * * if such assertions are false or misleading or are so incomplete as to mislead irrespective of whether the issuance of the release was motivated by corporate officials for ulterior purposes. * * *

In determining "whether the release was misleading, *i.e.*, whether it conveyed to the public a false impression of the drilling situation at the time of its issuance," the court rejected the district court's test that Texas Gulf was to "be judged *on the facts known to them* when the April 12 release was issued" (Pet. App. 113a, emphasis in original.) The "primary inquiry," in the view of the court of appeals, was "the meaning of the statement to the reasonable investor and its relationship to truth" (Pet. App. 114a).

While several of the court of appeals judges thought that the evidence established as a matter of law that Texas Gulf's April 12, 1964, press release was misleading and that its issuance violated Section 10(b) and Rule 10b–5 (Pet. App. 129a, 121a–122a, 128a), four judges were of the view that they could not "definitively conclude" from the record that it was deceptive or misleading to the reasonable investor (Pet. App. 115a). Accordingly, the district court was di-

rected to determine on remand "the character of the release in light of the facts existing at the time of the release, by applying the standard of whether the reasonable investor, in the exercise of due care, would have been misled by it" (*ibid.*). If so, the district court was to determine not whether Texas Gulf had "exercised 'reasonable *business* judgment under the circumstances'" but whether "the misleading statement resulted from a lack of due diligence on the part of" Texas Gulf (Pet. App. 116a, emphasis in original).

B. The Subsequent Decisions of the District Court and the Court of Appeals: The Appropriate Remedy.

THE INDIVIDUAL DEFENDANTS

On remand, following an evidentiary hearing, the trial court denied all relief against Messrs. Fogarty, Mollison and Stephens, finding that they had surrendered to Texas Gulf at their cost and without profit the stock or stock options they had acquired in violation of Rule 10b–5. The court found that the wide publicity accorded these defendants would serve as an adequate deterrent to future violations (Pet. App. 196a, 211a–212a), for which reason the trial court also refused to enjoin most of the other defendants (Pet. App. 196a–197a). The court issued injunctions, however, against Messrs. Crawford and Clayton, whose violations of Section 10(b) and Rule 10b–5 the court of appeals *en banc* had unanimously upheld (*supra*, p. 17), and who had "• • • purchased during the period of nondisclosure knowing beyond peradventure

of a doubt that TGS had made a very important mineral discovery" (Pet. App. 197a).

Pursuant to the Commission's request for relief other than injunctive, the district court also directed that defendants Darke, Holyk, Huntington and Clayton be deprived of the profits from their purchases of Texas Gulf stock or of calls on Texas Gulf stock on the basis of inside information, and that these profits be paid over to Texas Gulf to be held in escrow (Pet. App. 197a–210a). The court concluded that to do so was in accord with the congressional purpose to "protect the investing public by deterring possible future violations of Section 10(b) and Rule 10b–5" (Pet. App. 203a). Pursuant to the appellate court's instructions to determine the appropriate remedy for defendant Darke's "tipping" of other investors (Pet. App. 74a), the district court distinguished between "those who purchased TGS securities on Darke's recommendation and those who purchased on the recommendation of one of Darke's 'tippees' " and concluded that it would be a "sufficient deterrent" to direct Darke to pay Texas Gulf to hold in escrow "the profits realized by the 'tippees' who purchased on Darke's recommendation * * *" (Pet. App. 206a–207a).

With respect to Mr. Kline, the court refused to enjoin him from violating Section 10(b) and Rule 10b–5 by accepting Texas Gulf stock options while possessing material inside information (Pet. App. 213a). Pursuant to the mandate of the court of appeals, however, it entered judgment against him and directed

that he return his option to Texas Gulf to be cancelled (Pet. App. 212a–213a).

The court of appeals affirmed the judgment of the district court as to the individual defendants except with respect to Mr. Kline.[17] As to the remedy, the court affirmed the Commission's authority, pursuant to Section 21(e) to seek restitution, and an equity court's power, pursuant to Section 27, to grant that remedy as ancillary relief (Pet. App. 226a–230a).

TEXAS GULF'S APRIL 12, 1964, PRESS RELEASE

As to Texas Gulf, the district court, after reviewing the testimony of investor witnesses who had seen reports of the April 12 release in the news media,[18] held

[17] The court reversed the judgment ordering cancellation of Mr. Kline's option and, in effect, confessed error, noting that its prior "unambiguous instruction" ordering cancellation after the parties had specifically deferred the question of remedy deprived Mr. Kline of his day in court on that question (Pet. App. 230a). The case was remanded to the trial court (Pet. App. 231a), where on August 11, 1971, a hearing was held. On September 1, 1971, the trial court, in a memorandum opinion determined that, rather than cancelling his option, Mr. Kline should be deprived of any illegal profits obtained from the exercise of his option. *Securities and Exchange Commission* v. *Texas Gulf Sulphur Co.*, CCH Fed. Sec. L. Rep. ¶ 93,211 (S.D. N.Y., 1971). Judgment was entered on October 4, 1971.

[18] Texas Gulf asserted that it could only be held responsible for "the press release itself, not for the 'inaccurate or incomplete' version carried by the news media" (Pet. App. 188a). However the court rejected this argument stating:

"By issuing the press release 'For Immediate Release,' TGS was depending on the news media to report it to its shareholders. They could not have expected the news media to publish the entire press release, but only those portions which the media deemed important." (Pet. App. 189a). [continued]

"[o]n the basis of the standards laid down by the Court of Appeals," that the press release was "misleading to the reasonable investor using due care" and that "the framers did not exercise due diligence in its issuance" (Pet. App. 188a); therefore, the court ruled that Texas Gulf had violated Section 10(b) and Rule 10b–5. It noted, however, that there was no evidence of any other misleading press releases issued by the company in almost five years since the Timmins discovery, which the court termed a " 'once-in-a-lifetime affair' "; accordingly, it held that there was "no 'proper showing' " of any reasonable likelihood of future violations (Pet. App. 192a), and did not issue an injunction against the company.

The court of appeals held that the finding that Texas Gulf violated Rule 10b–5 "is well-founded and, in our view, unassailable" (Pet. App. 225a). The court concluded that the trial court did not abuse its discretion by allowing the admission of non-expert opinion testimony from investor witnesses, on the ground that their testimony was relevant to "[t]he ultimate issue [of] whether the release was 'misleading to the reasonable investor' " (Pet. App. 222a–223a). It also rejected Texas Gulf's claim that the finding of a violation of Rule 10b–5 for mere negligence in issuing the press

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Moreover, it pointed out:

"the fact that the news media emphasized the words which have been found to be misleading to the reasonable investor merely indicates that the news media also deemed them of importance. The failure of the broad tape to mention that a later statement would be issued indicates only that Dow Jones considered it relatively unimportant." (*Ibid.*)

release infringes its First Amendment rights, holding that Texas Gulf's April 12 report on its drilling progress was "commercial 'factual' speech" and, like other reports submitted by companies under the federal securities laws, was not within the protection afforded by the First Amendment (Pet. App. 224a–225a).

ARGUMENT

The courts below correctly rejected petitioners' narrow reading of Section 10(b) of the Securities Exchange Act and Rule 10b–5, both with respect to the scope of the activities covered and to the commission's remedies available in the event of violation. The court of appeals' holdings on these issues are not in conflict with decisions of other courts of appeals. Nor have petitioners raised any constitutional issues worthy of review. Indeed, although this case resolved several important questions, especially with respect to the use of inside information by corporate officials and a corporation's responsibility for the issuance of its press releases, the results reached by the court of appeals follow logically from the development of the federal securities laws in this area.[19]

More than six years have elapsed since the filing of the Commission's complaint, and more than three

[19] See Jennings, *Insider Trading in Corporate Securities: A Survey of the Hazards and Disclosure Obligations under Rule 10b–5*, 62 Nw. U. L. Rev. 809 (1968); Fleischer, *Securities Trading and Corporate Information Practices: The Implications of the Texas Gulf Sulphur Proceeding*, 51 Va. L. Rev. 1271 (1965); *Curent Policy Issues Involving Inside Information in the Securities Markets*, reprinted in 2 Securities L. Rev. 84 (1970).

years since the initial court of appeals opinion, yet none of the concerns expressed by the corporate and financial communities when the complaint was filed have been realized. There is no evidence, for example, that corporate announcements have been curtailed to the injury of the investing public or that competent corporate officials have left their employment for want of adequate forms of remuneration. Indeed, in general it appears that the business community has adapted its standards of conduct to conform with the principles set forth by the courts below without significant difficulty.[20] Petitioners appear to be more concerned with potential liability arising from private civil damage actions than with any alleged inconvenience to the corporate community; private civil actions, however, raise questions substantially different from those raised in Commission enforcement proceedings, which are brought in the public interest. There is no reason for the Court to address itself to those problems here.

1. We note at the outset that no judgment has been entered against petitioners Texas Gulf, Stephens, Fogarty or Mollison, nor do they contend that the findings[21] of which they complain have any effect in

[20] See *e.g.*, *New York Stock Exchange Company Manual* A-18—A-27 (1968); *American Stock Exchange Company Guide* § 401–406 (1970); see also West, *Timely Disclosure—The View from 11 Wall Street*, 24 Sw. L. J. 241 (1970); see generally, Bromberg, *Disclosure Programs for Publicly Held Companies—a Practical Guide*, 1970 Duke L. J. 1139.

[21] The recitals in the judgment cannot be characterized as a judgment against these petitioners. Cf. *Electrical Fittings Corp.* v. *Thomas & Betts Co.*, 307 U.S. 241, 242.

other actions against them. In these circumstances a party is not normally entitled to review of findings with which he does not agree, unless those findings would constitute *res judicata* or serve as the basis for collateral estoppel. See, *e.g.*, *New York Telephone Company* v. *Maltbie*, 291 U.S. 645; *Partmar Corp.* v. *Paramount Pictures Theatre Corp.*, 347 U.S. 89, 99 n. 6.[22] As to petitioner Kline, the order from which he seeks review remanded his case to the district court for a determination of the appropriate remedy. Judgment was subsequently entered against him on October 4, 1971,[23] but no appeal from that judgment has as yet been taken. The posture of his case is, therefore, comparable to its posture at the time this Court denied his earlier petition. 394 U.S. 976.

2. Petitioners contend (TG Pet. 21, 34–35) that the Commission, in an enforcement action brought

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[22] Subsequent cases have not held these findings to be *res judicata* or to have a collateral estoppel effect. See *Fink* v. *Coates*, 323 F. Supp. 988 (S.D. N.Y.), and *Cannon* v. *Texas Gulf Sulphur Co.*, 323 F. Supp. 990 (S.D. N.Y.); see also *Rachal* v. *Hill*, 435 F. 2d 59 (C.A. 5), certiorari denied, 403 U.S. 904. But Cf. *Sullivan* v. *Committee on Admissions and Grievances*, 395 F. 2d 594 (C.A. D.C.).

[23] The district court stated in its opinion on remand:

"Mr. Kline took the stand to stress the borderline nature of his violation and was vigorously cross-examined by the Commission. On the evidence, this Court cannot conclude that Mr. Kline knew less about the discovery than what the Court of Appeals found was sufficient basis for a violation of the Act and of the Rule. Indeed, in view of his trip to Utah with Mr. Fogarty a few days after November 12, 1963 and his responsibilities as General Counsel, it may be that he knew more about the initial drill hole than he originally testified to at the trial." *Securities and Exchange Commission* v. *Texas Gulf Sulphur Co.*, *supra*, CCH Fed. Sec. L. Rep. ¶93,211 at 91,350.

in the public interest, must prove all the elements of an ordinary damage suit, including scienter, intent to deceive, reliance, and consequent damages. This Court has noted, however, in *Securities and Exchange Commission* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 193, 200, involving an enforcement proceeding under the analogous antifraud provision of the Investment Advisers Act of 1940, 15 U.S.C. 80b–6, that "[i]t is not necessary in a suit for equitable or prophylactic relief to establish all the elements required in a suit for monetary damages" and that "[t]o impose upon the Securities and Exchange Commission the burden of showing deliberate dishonesty as a condition precedent to protecting investors through the prophylaxis of disclosure would effectively nullify the protective purposes of the statute."

Indeed, petitioners' restrictive construction of Section 10(b) of the Securities Exchange Act conflicts with the principle that "securities legislation 'enacted for the purpose of avoiding frauds'" is to be construed "flexibly to effectuate its remedial purposes," without regard to technical and restrictive notions of intent. *Securities and Exchange Commission* v. *Capital Gains Research Bureau, Inc., supra,* 375 U.S. at 195; see also, *Tcherepnin* v. *Knight*, 389 U.S. 332, 336; cf. *Ellis* v. *United States,* 206 U.S. 246, 257. In passing the Act, Congress recognized that "[s]peculation, maniulation, * * * investors' ignorance, and disregard of trust relationships by those whom the law should regard as fiduciaries" were "all a single seamless web * * *" H.R. Rep. No. 1383, 73rd Cong., 2d Sess., 6

(1934). As this Court has recently observed with respect to the quoted congressional language:

> Since practices "constantly vary and where practices legitimate for some purposes may be turned to illegitimate and fraudulent means, broad discretionary powers" in the regulatory agency "have been found practically essential." Id., at 7. Hence * * * Section 10(b) must be read flexibly, not technically and restrictively. Since there was a "sale" of a security and since fraud was used "in connection with" it, there is redress under § 10(b), whatever might be available as a remedy under state law.[24] [Superintendent of Insurance of New York v. Banker's Life and Casualty, No. 70–60, decided Nov. 8, 1971, slip op., pp. 5–6.]

The decision of the court below, in recognizing that the scope of Section 10(b) was intended to be as broad as the Act itself (Pet. App. 92a–93a; 105a–113a), serving as a "catchall" to fill gaps left by more specific provisions,[25] is in accord with the decisions of this Court and other courts of appeals.[26]

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[24] See also, 78 Cong. Rec. 7696 (1934) (Remarks of Rep. Rayburn). The Senate Committee viewed the Securities Act of 1933 and the Securities Exchange Act of 1934 as vesting "in the Securities and Exchange Commission jurisdiction over the source of and traffic in securities." S. Rep. No. 1455, 73d Cong., 2d Sess. 393 (1934).

[25] *Hearings before House Committee on Interstate and Foreign Commerce on H.R. 7852 and 8720*, 73d Cong., 2d Sess. 115 (1934); see also H. Rep. No. 1383, 73d Cong., 2d Sess. 6–7 (1934), and S. Rep. No. 792, 73d Cong., 2d Sess. 5–6 (1934).

[26] See *Herpich* v. *Wallace*, 430 F. 2d 792, 806 (C.A. 5); *Rekant* v. *Desser*, 425 F. 2d 872 (C.A. 5); *Kahan* v. *Rosenstiel*, 424 F. 2d 161, 172 (C.A. 3), certiorari denied *sub nom. Glen Alden Corp.* v. *Kahan*, 398 U.S. 950; *Matheson* v. *Armbrust*, 284 F. 2d 670, 674 (C.A. 9). See also *Heit* v. *Weitzen*, 402 F. 2d 909 (C.A. 2), certiorari denied, 395 U.S. 903.

3. The courts below correctly held that the April 12 press release, which was issued to counteract the market effect of newspaper reports (J.A. 853a, 854a, 863a, 866a–867a, 939a), was issued "in connection with" the purchase and sale of securities (Pet. App. 105a–113a). The "in connection with" clause in Section 10(b) has been described as "plainly and—one must assume—intentionally the loosest linkage, in any of the federal antifraud provisions, between a proscribed act and a security transaction."[27] Cf. *Superintendent of Insurance of New York* v. *Bankers Life and Casualty, supra.* As noted by the court below, comparison with the other antifraud provisions in the federal securities laws makes clear "that when Congress intended that there be a participation in a securities transaction as a prerequisite of a violation, it knew how to make that intention clear" (Pet. App. 109a). The Second Circuit's construction of this phrase[28] is consistent with that of other courts.[29]

[27] Bromberg, *Securities Law: Fraud-SEC Rule 10b–5*, § 7.6(1) at 190.21.

[28] See also *Securities and Exchange Commission* v. *Great American Industries, Inc.*, 407 F. 2d 453 (*en banc*), certiorari denied, 395 U.S. 920; *Heit* v. *Weitzen, supra*, 402 F. 2d 909. But see, *Superintendent of Insurance of New York* v. *Bankers Life and Casualty*, 430 F. 2d 355 (C.A. 2), reversed this Term, No. 70–60, November 1, 1971.

[29] See, *e.g.*, *Herpich* v. *Wallace, supra*, 430 F. 2d 792; *Kahan* v. *Rosensteil, supra*, 424 F. 2d at 172; *Hooper* v. *Mountain States Securities Corp.*, 282 F. 2d 195 (C.A. 5), certiorari denied, 365 U.S. 814; *Freed* v. *Szabo Food Service, Inc.*, CCH Fed. Sec. L. Rep. ¶91,317 (N.D. Ill.); *Stockwell* v. *Reynolds & Co.*, 252 F. Supp. 215 (S.D. N.Y.); *Meisel* v. *North Jersey Trust Co.*, 218 F. Supp. 274, 279 (S.D. N.Y.).

The fact that Congress specifically provided for the filing of periodic and other specified reports with the Commission [30] does not imply, as Texas Gulf suggests (TG Pet. 24), that Congress intended that other corporate reports and annoucements be unregulated. One of the basic purposes of the Act was "to insure the maintenance of fair and honest markets" in securities transactions,[31] and as the House Report on the bill stated, "There cannot be honest markets without honest publicity. * * *" [32] Furthermore, the decision below does not, as petitioner Texas Gulf implies (TG Pet. 25), require directors to guarantee the accuracy of every statement which the company makes. The decision requires merely that persons preparing a press release which will affect the market for their corporation's securities use "due diligence" in reporting the facts.

Texas Gulf complains (TG Pet. 26) that the court of appeals' standard [33] for judging the press release—

[30] See Sections 13 and 15(d) of the Act, 15 U.S.C. 78m, 78o(d). The Commission has established a detailed reporting system under these provisions. See Rules 13a-1 to 13b-1, 15d-1 to 15d-21, 17 CFR 240.13a-1 to 240.13b-1, 240.15d-1 to 240.15d-21. It is, of course, implicit in the reporting requirements that the documents filed with the Commission must be complete and accurate.

[31] Section 2 of the Act, 15 U.S.C. 78b.

[32] H. Rep. No. 1383, 73d Cong., 2d Sess. 11 (1934).

[33] In assuming that the court of appeals' standard is based on "the subjective reactions of persons in the market" (TG Pet. 26), petitioners fail to distinguish between the opinion testimony of investor-witnesses, which was relevant to the ultimate issue, and the ultimate issue itself, *i.e.*, whether the re-

"whether the reasonable investor, in the exercise of due care, would have been misled by it" (Pet. App. 115a)—is excessively subjective. In fact, this standard is no more subjective than th reasonable man standard uniformly employed in tort law. See Prosser, *Torts*, 153–168 (Hornbook ed., 1964). Furthermore, the court correctly determined that Texas Gulf's conduct should be judged "in the light of the facts existing at the time of the release" (Pet. App. 115a), and that a finding of violation required also the determination that, in light of these facts, the draftsmen failed to exercise "due diligence" (Pet. App. 116a). The district court's initial finding that "on the basis of the facts known to its draftsmen at the time of its preparation" the press release was an exercise of "reasonable business judgment" (Pet. App. 116a) cannot be equated with a finding of "due diligence" under the court of appeals' test, as Texas Gulf asserts (TG Pet. 26–27). The district court recognized this distinction in finding on remand that "on the basis of the standards laid down by the Court of Appeals * * * the framers of the press release failed to exercise due diligence" (Pet. App. 188a).

4. The court of appeals applied two alternative phrasings of the standard of materiality applicable in Rule 10b–5 cases: that the information is important

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lease was misleading to the reasonable investor (Pet. App. 222a). The Commission offered testimony of investor witnesses solely to buttress its contention that the release on its face was misleading.

to a "reasonable" investor and that "in reasonable and objective contemplation" it might affect the market price of the stock (see p. 16, *supra*).[34] Other courts of appeals have adopted both of these standards.[35] Of

[34] Petitioners argue that the court of appeals correctly stated that a *substantial* prospective market impact is necessary to render inside information material and then departed from this standard by dispensing with the requirement of substantiality (HDC Pet. 13; H. Pet. 9–11). We read the phrase "in reasonable and objective contemplation," used by the court below in this case (Pet. App. 87a) and in its earlier decision cited by petitioners (TG Pet. 21), *List* v. *Fashion Parks, Inc.*, 340 F. 2d 457, 462, (C.A. 2), certiorari denied *sub nom. List* v. *Lerner*, 382 U.S. 811, to exclude matters which might cause insubstantial market fluctuations. Moreover, it is difficult to see how investment judgment could be affected without affecting market value.

[35] *Myzel* v. *Fields*, 386 F. 2d 718, 734 and n. 7 (C.A. 8), certiorari denied, 390 U.S. 951; *Rogen* v. *Ilikon Corp.*, 361 F. 2d 260, 266 (C.A. 1); *Kohler* v. *Kohler Co.*, 319 F. 2d 634, 642 (C.A. 7); accord, *Securities and Exchange Commission* v. *R. A. Holman & Co.*, 366 F. 2d 456, 458, rehearing denied *per curiam*, 377 F. 2d 665 (C.A. 2), certiorari denied, 389 U.S. 991; *List* v. *Fashion Park, Inc.*, *supra*, 340 F. 2d at 462. The Second Circuit has used the first phrasing subsequent to the decision below, with one of the two dissenting judges here joining in the opinion. *Securities and Exchange Commission* v. *Great American Industries, Inc.*, *supra*, 407 F. 2d at 459–466. See also, *e.g.*, *Lehigh Valley Trust Co.* v. *Central National Bank*, 409 F. 2d 989, 993 (C.A. 5); *Northwest Paper Corp.* v. *Thompson*, 421 F. 2d 137, 138 (C.A. 9); *Chasins* v. *Smith, Barney & Co.*, 438 F. 2d 1167, 1171 (C.A. 2). And cf. opinion of Justice Harlan in *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 384, to the effect that a material fact in a proxy statement is one "of such a character that it might have been considered important by a reasonable shareholder who was in the process of deciding how to vote."

the two courts of appeals' decisions which petitioners claim are inconsistent with that of the court below (TG Pet. 31–32), one, *James Blackstone Memorial Library Assn'* v. *Gulf, M. & O. R.R. Co.*, 264 F. 2d 445, 450–451 (C.A. 7), certiorari denied, 361 U.S. 815, is an earlier decision of one of the courts which has since specifically adopted the second phrasing (see n. 35 *supra*), and in any event the undisclosed information involved in that case could not possibly have affected the fair market value of the plaintiff's stock.[36] The other, *Sunray Oil Co.* v. *Helmerich & Payne, Inc.*, 398 F. 2d 447 (C.A. 10), does not articulate any standard of materiality, and there is no indication that the drilling results in that case were in any way comparable to the "remarkable discovery" of Texas Gulf (R. 1717; see pp. 8, 13, *supra*);[37] moreover, two of the three judges who decided *Sunray* specifically held that case inapplicable in *Mitchell* v. *Texas Gulf Sulphur Co.*, 446 F. 2d 90, 100 (C.A. 10), petition for certiorari filed (No. 71–421).

In refusing to limit the concept of "reasonable" investors to whom information might be material to long-term, "conservative" investors, the court of ap-

[36] The undisclosed information concerned the possibility that certain property in the corporation's name might be sold to the government at an advantageous price. All the property of the corporation had already been leased to another party in perpetuity, however, and a sale at large profit would not have affected the guaranteed dividend, which is all that plaintiffs were entitled to receive. 264 F. 2d at 447–448, 450.

[37] Neither of the two well holes in the *Sunray* case was on the land where the company had drilling rights; one was more than a mile away. See unreported findings of fact and conclusions of law in the district court, p. 7, No. 68 C 92 (N.D. Okla.)

peals did not depart from the traditional test of materiality, as Texas Gulf suggests (TG Pet. 31). The Act protects speculators as well as conservative investors. Although one of the purposes of the Act was to curb *excessive* speculation, the House Committee Report stated: "There is plenty of room for legitimate speculation in the balancing of investment demand and supply * * *. No investor, no speculator can safely buy and sell securities upon the exchanges without having an intelligent basis for forming his judgment as to the value of the securities he buys or sells."[38] Certain of the filings with the Commission required under the Securities Act of 1933 relate to securities which would be of interest only to speculators[39] while others describe securities that might appeal to more conservative investors.

Having rejected the test of materiality applied by the district court (see p. 16 *supra*,) the court of appeals in reviewing the district court's decision was not bound, as petitioners contend (HDC Pet. 15–17; H. Pet. 15–17; TG Pet. 36–37), by that court's conclusions as to materiality. This Court has repeatedy held that Rule 52(a) of the Federal Rules of Civil Procedure does not cover findings of fact based upon the application of erroneous legal standards to undisputed eviden-

[38] H. Rep No. 1383, 73d Cong., 2d Sess. 11 (1934).

[39] The Commission has a special registration form for securities of a speculative nature, which must be so labeled. Form S–2, General Instruction D(b), reprinted in 1 CCH Fed. Sec. Law Rep. ¶7142, at 6241–6242; see, also, Form S–3, General Instruction E(b), reprinted in 1 CCH Fed. Sec. Law Rep. ¶7152, at 6262.

tiary facts. *E.g., United States* v. *General Motors Corp.*, 384 U.S. 127, 142 n. 16; *United States* v. *Parke, Davis & Co.*, 362 U.S. 29, 44.[40]

5. All of the judges of the court of appeals sitting *en banc*, as well as the district judge agreed that Section 10(b) and Rule 10b–5 prohibit a corporate insider from trading in his corporation's securities on the basis of important inside information not available to the public. This is also the view of all other federal courts that have considered the matter.[41] Contrary to petitioners' argument that they had no "fair warning" as to this meaning of Rule 10b–5 (TG Pet. 38–39), the Commission has repeatedly expressed this interpretation of its rule in formal adjudications,[42] in

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[40] See generally, 5 Moore's *Federal Practice* ¶52.03[3] and 52.04. The fact that other provisions of the securities acts have been interpreted to contain differing definitions of materiality does not affect the applicable standard in this case (see TG Pet. 30). Cf. *Securities and Exchange Commission* v. *National Securities, Inc.*, 393 U.S. 453, 466.

[41] *E.g., Myzel* v. *Fields*, *supra*, 386 F. 2d 718; *List v. Fashion Park, Inc.*, *supra*, 340 F. 2d 457, 461–462; *Kohler* v. *Kohler Co.*, *supra*, 319 F. 2d 634; *Reed* v. *Riddle Airlines*, 266 F. 2d 314 (C.A. 5); *Cochran* v. *Channing Corp.*, 211 F. Supp. 239, 242–243 (S.D.N.Y.); *Speed* v. *Transamerica Corp.*, 99 F. Supp. 808 (D. Del.), final judgment awarded, 135 F. Supp. 176 (D. Del.), affirmed as modified, 235 F. 2d 369 (C.A. 3); *Kardon* v. *National Gypsum Co.*, 73 F. Supp. 798 (E.D. Pa.), modified in other respects, 83 F. Supp. 613 (E.D. Pa.); *Mansfield Hardwood Lumber Co.* v. *Johnson*, 268 F. 2d 317, 319 n. 3 (C.A. 5) (dictum), certiorari denied, 361 U.S. 885; cf. *Strong* v. *Repide*, 213 U.S. 419, 431; and *Diamond* v. *Oreamuno*, 24 N.Y. 2d 494, 301 N.Y.S. 2d. 78.

[42] The first opinion by the Commission under Rule 10b–5 was issued "to call attention" to the rule and to the Commission's view that it was a violation for insiders, without disclosing a

enforcement actions in the courts,[42] in *amicus curiae* briefs in private actions,[43] and in pamphlets describing its activities to the public and reports to Congress.[44]

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plan to liquidate the corporation at a large premium over the market price of the stock, to cause their corporation to purchase its stock from the minority public shareholders, thereby increasing the value of the insiders' holdings "almost to the same extent as if they had purchased such shares for themselves." *Ward LaFrance Truck Corp.*, 13 S.E.C. 373, 374, 376, 381; *accord*, *R. D. Bayley & Co.*, 19 S.E.C. 773, 784; *Hughes & Treat*, 22 S.E.C. 623, 626 (dictum); *Cady, Roberts & Co.*, 40 S.E.C. 907.

[42] *E.g.*, *Securities and Exchange Commission* v. *First Investment Co.* D.N.H. (Litigation Release No. 281, June 20, 1945); *Securities and Exchange Commission* v. *Boyd Transfer & Storage Co.* (D. Minn.) (Litigation Release No. 295, Aug. 20, 1945; Litigation Release No. 308, Dec. 7, 1945); *Securities and Exchange Commission* v. *Gentile* (S.D. N.Y.) (Litigation Release No. 323, Feb. 12, 1946); *Securities and Exchange Commission* v. *Redfield* (D. Mass.) (Litigation Release No. 899, Feb. 24, 1955); *Securities and Exchange Commission* v. *Aldred Investment Trust* (S.D. N.Y.) (Litigation Release No. 2081, Aug. 11, 1961). These actions were settled when the violators consented to injunctive relief and, in at least some cases, agreed to make restitution.

[43] *E.g.*, Memorandum of the Commission, *Amicus Curiae*, p. 3, Reply Memorandum of the Commission, *Amicus Curiae*, pp. 4–17, and the Supplemental Reply Memorandum of the Commission, pp. 7–16, in *Speed* v. *Transamerica Corp.*, *supra*, 99 F. Supp. 808.

[44] Securities and Exchange Commission, Work of the Securities and Exchange Commission 8 (1951, 1952, 1954 eds.), 9 (1957, 1960, 1961, 1962, 1964, 1965, 1966 eds.) (title varied in 1964 and 1965 eds.); Securities and Exchange Commission, Thirteenth Annual Report 63–64 (1947), Fifteenth Annual Report 72 (1949); see also "Study of Securities and Exchange Commission," *Hearings Before a Subcommittee of the House Committee on Interstate and Foreign Commerce*, 82d Cong., 2d Sess. 723–726 (1952).

Petitioners do not appear to contend that the corporate employees in question here are not "insiders" as that term has been used in the context of Section 10(b),[46] or that a corporate official, who cannot himself purchase stock without disclosure, may give tips on the basis of the same material information to friends, relatives and business associates so that they can use the information in securities transactions without disclosure.[47] They argue (TG Pet. 33), however, that "[t]he legislative history clearly demonstrates that, absent a showing of fraud or deceit,

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[46] The trial court's holding that "insiders subject to the disclosure requirements of Section 10(b) and Rule 10b–5 may include employees as well as officers, directors, and controlling stockholders who are in possession of material undisclosed information obtained in the course of their employment" (Pet. App. 23a) was unanimously upheld by the court of appeals (Pet. App. 85a–86a, 119a, 128a, 170a). Accord, *e.g.*, *Ross* v. *Licht*, 263 F. Supp. 395 (S.D.N.Y.); 3 Loss, *Securities Regulation* 1450–1454 (2d ed. 1961); Fleischer, *Securities Trading and Corporate Information Practices: The Implications of the Texas Gulf Sulphur Proceeding*, 51 Va. L. Rev. 1271, 1280–1282 (1965).

[47] Petitioner Darke, who was found to have violated Section 10(b) and Rule 10b–5 for tipping, does not appear to contend that such a tip would be lawful if given with knowledge that the information was not available to the investing public. See *Kuehnert* v. *Texstar Corp.*, 412 F. 2d 700 (C.A. 5); *Wohl* v. *Blair & Co.*, 50 F.R.D. 89 (S.D.N.Y.); *Ferraioli* v. *Cantor*, 281 F. Supp. 354 (S.D.N.Y.); *Ross* v. *Licht*, 263 F. Supp. 395 (S.D.N.Y); *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, CCH Fed. Sec. L. Rep. ¶77,629 (S.E.C.); cf. *Investors Management Co., Inc.*, CCH Fed. Sec. L. Rep. ¶78,163 (S.E.C.); *Blyth & Co.*, CCH Fed. Sec. L. Rep. ¶77,647 (S.E.C.); *Herbert L. Honohan* 13 S.E.C. 754, 757–758, modified in other respects, 16 S.E.C. 297; 3 Loss, *Securities Regulation*, *supra*, 1450–1451. See also, *Mosser* v. *Darrow*, 341 U.S. 267, 271–272.

Section 16(b) was designed to be the sole prohibition against insider trading." Section 16(b) provides that a corporation may recover profits realized in short-swing transactions by directors, officers and large stockholders of the corporation regardless of whether they have traded on inside information. As the district court noted at length, there are significant differences between Section 10(b) and Section 16(b) and the provisions of the latter impose no limitation on the former (Pet. App. 20a–26a). Cf. *Securities and Exchange Commission* v. *Chenery Corp.*, 318 U.S. 80, 91; *Securities and Exchange Commission* v. *National Securities Inc., supra*, 393 U.S. at 465–466. Furthermore, the fact that Congress deleted from an early draft of what became Section 16(b) certain other provisions relating to insider trading does not indicate any lack of concern for the abuse in question here.[45]

[45] The original bills introduced in Congress not only provided for the recovery of profits from short-swing transactions but also outlawed purchases made with intent to engage in short-swing transactions as well as tips of inside information and provided for the recovery by the corporation of profits from tips. H.R. 7852, S. 2693, § 15(b), 73d Cong., 2d Sess. (1934). At the hearings it was indicated that as written these provisions involved difficult problems of interpretation and proof. *Hearings Before the House Committee on Interstate and Foreign Commerce on H.R. 7852 and 8720*, 73d Cong., 2d Sess. 133–138 (1934); *Hearings Before the Senate Committee on Banking and Currency on S. Res. 84 (72d Con.) and S. Res. 56 and 97 (73 Cong.)* 73d Cong., 1st and 2d Sess. 6556–6561, 6954–6955 (1934); *Blau* v. *Lehman*, 368 U.S. 403, 412 n.12; *Smolowe* v. *Delendo Corp.*, 136 F. 2d 231, 236 (C.A. 2), certiorari denied, 320 U.S. 751. Thus, the subsequent versions of the bills reported out in both houses omitted these provisions,

As the court of appeals noted (Pet. App. 86a n. 9), the legislative history indicates that "Congress intended by the Exchange Act to eliminate the idea that the use of inside information for personal advantage was a normal emolument of corporate office." Indeed, the Senate Report stated: "Among the most vicious practices unearthed * * * [in the legislative hearings] was the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information which came to them in such positions, to aid them in their market activities."[49] This legislative history indicates that the power delegated to the Commission in Section 10(b) to define "any manipulative or deceptive device or contrivance" includes the power to prohibit a wide range of abuses in the area of insider trading.

Petitioners imply (TG Pet. 34) that the use of inside information for trading activities should not be unlawful if those activities are carried out in an anonymous exchange market. Such a limitation, as the Second Circuit has previously indicated, "would be

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and the House version even omitted what is now Section 16(b). H.R. 9323, § 15, S. 3420, § 16, 73d Cong., 2d Sess. (1934); the Senate version of what is now Section 16 was accepted in conference, H.R. Rep. No. 1838, 73d Cong., 2d Sess. 35–36 (1934), and enacted, apparently on the premise that the imposition of liability without any showing of abuse of inside information went beyond even the broad rulemaking powers given to the Commission.

[49] S. Rep. No. 1455, 73d Cong., 2d Sess. 55 (1934). This language is contained in the section of the report dealing with "Market Activities of Directors, Officers, and Principal Stockholders of Corporations."

contrary to the intent of Congress, as set forth in Section 2 of the Securities Exchange Act, 15 US.C. § 78b, which was to regulate 'transactions in securities as commonly conducted upon securities exchanges [as well as] over-the-counter markets.'" *List* v. *Fashion Park, Inc., supra,* 340 F. 2d at 462.[50] Indeed, disclosure is perhaps most important in impersonal transactions, such as those carried out on a stock exchange, because the stockholder who deals with an insider on a face-to-face basis has an opportunity to make informal inquiry whether the insider is in possession of any material information not available to the public.[51] As the court of appeals pointed out, abuse of inside information allows insiders to obtain "secret corporate compensation * * * at the expense of the uninformed investing public * * *. Such inequities based upon unequal access to knowledge should not be shrugged off as inevitable in our way of life, or, in

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[50] The *List* opinion also answered petitioners' contention that purchases of stock on a national securities exchange on the basis of material inside information do not induce other investors to sell their stock at that time (TG Pet. 34–35), pointing out that the concept of reliance is not limited to a situation in which the investor

> actively relied on the silence of the defendant, either because he consciously had in mind the negative of the fact concealed, or perhaps because he deliberately put his trust in the advice of the defendant. * * * The proper test is whether the plaintiff would have been influenced to act differently than he did act if the defendant had disclosed to him the undisclosed fact. * * *

340 F. 2d at 463. Accord, *Myzel* v. *Fields, supra,* 386 F. 2d at 735.

[51] Cf. *Broffe* v. *Horton,* 172 F. 2d 489, 494 (C.A. 2).

view of the congressional concern in this area, remain uncorrected" (Pet. App. 92a–93a).

6. With respect to the question of remedy, petitioners contend that in a suit brought by the Commission, the district court could grant no more than an injunction and that it was without power to order restitution and other relief (HDC Pet. 12–20; TG Pet. 40–41). This Court has held, however, that the grant of jurisdiction in Section 27 of the Securities Exchange Act permits the courts to grant appropriate remedies to effectuate the purposes of the Act and to deter future violations thereof. *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 386; *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 433–435; accord, *Deckert* v. *Independence Corp.*, 311 U.S. 282; cf. *Textile Workers Union* v. *Lincoln Mills*, 353 U.S. 448. In other contexts the Court has upheld the power of the government to seek, and the courts to grant, restitution as an ancillary remedy in spite of the absence in the statutory language of "affirmative confirmation of the power to order reimbursement." *Mitchell* v. *DeMario Jewelry*, 361 U.S. 288, 291–292; accord, *Porter* v. *Warner Holding Co.*, 328 U.S. 395; see also *Sullivan* v. *Little Hunting Park*, 396 U.S. 229, 239; *Jones* v. *Alfred H. Mayer Co.*, 392 U.S. 409, 414 and n. 13. In fact, the court may grant restitution even though injunctive relief is neither sought nor granted. See *United States* v. *Moore*, 340 U.S. 616, 620, n. 6.[52]

[52] Section 21(e) of the Act, which refers only to injunctive relief, does not limit the Commission's authority to invoke the courts' general equity powers to afford complete relief. See *e.g.*, *Lankenau* v. *Coggeshall & Hicks*, 350 F. 2d 61 (C.A.

"An order of restitution is not a judgment for damages or for penalties. It compels compliance and is restorat[ive] of the status quo which falls within the recognized power of a court of equity." *Bowles* v. *Skaggs,* 151 F. 2d 817, 821 (C.A. 6); accord, *e.g., Mitchell* v. *DeMario Jewelry, supra,* 361 U.S. at 293; *Schine Chain Theatres, Inc.* v. *United States,* 334 U.S. 110, 128. Petitioners here were "merely deprive[d] * * * of the gains of their wrongful conduct" (Pet. App. 228a–229a).[53] *Ibid.* Indeed, the formula employed by the court permitted petitioners to retain profits accruing after April 17, 1964 (the day following the announcement that Texas Gulf had a "major strike"). With respect to Mr. Darke, who was held liable for the profits of his tippees, the court recognized that "more of a hardship is imposed" on

2); *Los Angeles Trust Deed & Mortgage Exchange* v. *Securities and Exchange Commission,* 285 F. 2d 162, 181–182 (C.A. 9), certiorari denied, 366 U.S. 919; see generally J. W. Wade and R. D. Kamenshine, *Restitution for Defrauded Consumers: Making the Remedy Effective Through Suit by Governmental Agency,* 37 Geo. Wash. L. Rev. 1031, 1048–1056 (1969). Indeed, the Commission has obtained restitution or rescission in other cases. See, *e.g., Securities and Exchange Commission* v. *Golconda Mining Co.,* CCH. Fed. Sec. L. Rep. ¶93,058 (S.D. N.Y.); *Securities and Exchange Commission* v. *Wong.* 252 F. Supp. 608, 613–614 (D.P.R.). This is consistent with *Securities and Exchange Commission* v. *C. M. Joiner Leasing Corp.,* 320 U.S. 344, 350–351, where this Court declined to invoke the concept of *expressio unius est exclusio alterius* to limit the scope of securities legislation.

[53] The court of appeals rejected petitioners' contentions that a penalty was involved because under the judgment Texas Gulf might retain the fund even though it was not damaged

him,[54] but "without such a remedy, insiders could easily evade their duty to refrain from trading on the basis of inside information"[55] since the transaction "could be concluded by a relative or an acquaintance * * * or implied understandings could arise under which reciprocal tips between insiders in different corporations could be given" (Pet. App. 229a). Cf. *Mosser* v. *Darrow*, 341 U.S. 267, 271–272.[56]

7. Finally petitioners make a number of constitutional and procedural arguments which we submit are without merit. Texas Gulf contends that the court of appeals' determination that the issuance of a false press release may violate Section 10(b) of the Securities Exchange Act contravenes the First Amendment (TG Pet. 27–30). In *Donaldson* v. *Read Magazine*,

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by this breach of fiduciary duty (Pet. App. 229a–230a). "[T]he primary concern, in a case such as this, is not to determine whether the corporation has been damaged but to decide, as between the corporation and the defendants, who has a higher claim to the proceeds derived from the exploitation of the information." *Diamond* v. *Oreamunó*, *supra*, 24 N.Y. 2d at 498, 499, 301 N.Y.S. 2d at 81–82. Nevertheless, the corporation, which has "a great interest in maintaining a reputation of integrity, an image of probity, for its management and in ensuring the continued public acceptance and marketability of its stock," is injured by their conduct. *Ibid.*

[54] The district court did not charge Mr. Darke with the profits of his tippees' tippees and the Commission did not appeal from that ruling (Pet. App. 206a–207a).

[55] Section 20(b) of the Act, 15 U.S.C. 78t(b), specifically makes it "unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under * * * [the Act] through or by means of any other person."

[56] The district court did not abuse its discretion in enjoining Messrs. Crawford and Clayton since, as the court of appeals noted, there was "sufficient distinction in [their] cases for the district court to single them out" (Pet. App. 225a).

Inc., 333 U.S. 178, 190, however, this Court stated that the "governmental power" utilized in the Securities Exchange Act and other specified antifraud statutes in making false statements unlawful "has always been recognized in this country and is firmly established." *Donaldson* upheld the validity of an order depriving respondents "of a right to speak or print * * * to the extent necessary to protect others from * * * fraudulent artifices." 333 U.S. at 191. While a tolerance for negligence by conduits of information and topical views (such as newspapers and pamphleteers) may be necessary to assure a free flow of ideas,[57] the protection of the investing public from material misstatements by corporate officials affecting the market value of the corporation's publicly-traded stock clearly outweighs any "right" of these officials to make public statements without exercising due diligence in determining their accuracy.[58] Accordingly,

[57] See, *e.g.*, *New York Times Co.* v. *Sullivan*, 376 U.S. 254, 278–279; *Rosenbloom* v. *Metromedia, Inc.*, 403 U.S. 29.

[58] Some courts have questioned whether commercial speech, such as that involved here, involves issues "about which information is needed or appropriate to enable the members of society to cope with the exigencies of their period," *Thornhill* v. *Alabama*, 310 U.S. 88, 102, as Texas Gulf asserts (TG Pet. 29). See, *e.g.*, *Valentine* v. *Chrestensen*, 316 U.S. 52; *New York State Broadcasters Assoc.* v. *United States*, 414 F. 2d 990, 996–997 (C.A. 2), certiorari denied, 396 U.S. 1061 *Banzhaf* v. *Federal Communications Commission*, 405 F. 2d 1082, 1101–1102 (C.A. D.C.), certiorari denied *sub nom. Tobacco Institute* v. *Federal Communications Commission*, 396 U.S. 842; cf. *Curtis Publishing Co.* v. *Butts*, 388 U.S. 130, 150; *Breard* v. *City of Alexandria*, 341 U.S. 622, 642; *Murdock* v. *Pennsylvania*, 319 U.S. 105, 110–111; *Martin* v. *City of Struthers*, 319 U.S. 141, 142 n.1.

the court below correctly held (Pet. App. 224a-225a) that, in balancing unfettered corporate or commercial speech against injury to the public resulting from misleading or fraudulent corporate press releases, such commercial speech is not entitled to constitutional immunity. *Securities and Exchange Commission* v. *Wall Street Transcript Corp.*, 422 F. 2d 1371, 1379–1380 (C.A. 2), certiorari denied, 398 U.S. 958. See also, *United States* v. *Amick*, 439 F. 2d 351, (C.A. 7), certiorari denied, No. 70–134, Oct. 12, 1971; *Securities and Exchange Commission* v. *May*, 229 F. 2d 123 (C.A. 2); *Halsted* v. *Securities and Exchange Commission*, 182 F. 2d 660, 668 (C.A.D.C.).

Petitioners argue that in contravention of "the Fifth Amendment and well-settled principles of administrative procedure" (TG Pet. 38; H Pet. 18; HDC Pet. 23; C Pet. 26–27), Rule 10b–5 afforded them insufficient warning of the conduct it proscribes. But, as we have pointed out (pp. 36–37, *supra*), the prior consistent administrative and judicial interpretations of that rule furnished petitioners with ample notice that the rule proscribed the activities they engaged in. Cf. *Jordan* v. *DeGeorge*, 341 U.S. 223, 231–232. Where deceptive activity is involved, this Court has warned that "to define strictly the species or evidences of it," would result in jurisdiction over such activity being "perpetually eluded by new schemes which the fertility of man's invention would contrive." [59] Moreover,

[59] *Securities and Exchange Commission* v. *Capital Gains Research Bureau, Inc.*, *supra*, 375 U.S. at 193 n. 41, quoting from letter of Lord Hardwicke to Lord Kames, dated June 30, 1759.

this Court has recognized that "the choice made between proceeding by general rule or by individual, *ad hoc* litigation is one that lies primarily in the informed discretion of the administrative agency." *Securities and Exchange Commission* v. *Chenery Corp.*, 332 U.S. 194, 203.[60]

Petitioners also argue (C Pet. 12; TG Pet. 41; H Pet. 19) that they were entitled to oral argument after the lower court determined to decide the case *en banc*. On May 2, 1968, three months prior to its decision in this case, the court of appeals advised the parties that "* * * the appeal [would] be considered in banc by all the active judges of the Court upon the record and the briefs [t]heretofore filed, and the opinions written by the judges who heard the argument of the appeal, without further argument" (C.A. 2, Docket No. 30882). No motion for leave to present additional oral argument was made by any of the parties at that time. Thus even if petitioners had a right to be heard orally by the full panel of court below, it would appear that they waived this right. In any event, no such "right" (C. Pet. 19) is an element of due process. *Federal Communications Commission* v. *WJR*, 337 U.S. 265, 275. Nor does Section 46(c) of Title 28 of the United States Code or the Federal Rules of Appellate Procedure, upon which petitioners rely (C.

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[60] Cf. *National Labor Relations Board* v. *Wyman-Gordon Co.*, 394 U.S. 759, 771–772 (opinion of Mr. Justice Black); *Columbia Broadcasting System* v. *United States*, 316 U.S. 407, 421. As this Court made clear in *Chenery*, *supra*, the fact that proceeding by litigation "might have a retroactive effect" is "not necessarily fatal to its validity." 332 U.S. at 203.

Pet. 12–22), provide that parties have a "right" to oral argument before the full court. This Court has repeatedly stated that:

> § 46(c) is not addressed to litigants. It is addressed to the Court of Appeals. It is a grant of power. It vests in the court the power to order hearings *en banc*. It goes no further. * * * [61]

While Rule 34 of the Federal Rules of Appellate Procedure provides for oral argument, Rule 2 authorizes a court of appeals to "suspend the requirements or provisions of any of these rules in a particular case * * * on its own motion and [to] order proceedings in accordance with its direction."

Petitioner Crawford also urges (C Pet. 30–32) that the use of the words "material" and "disclosed" in the permanent injunction entered against him are unconstitutionally "vague" and "subjective." In support of this contention he points to purported differences between the court of appeals and the district court in deciding what was material in this case. There was no such difference, however, with respect to the activities of Mr. Crawford, who knew that the April 16 press release that was about to be issued contained material information which had not been disclosed publicly when he made his purchases of

[61] *Western Pacific R.R. Corp.* v. *Western Pacific R.R. Co.*, 345 U.S. 247, 250. This language was quoted in *Shenker* v. *Baltimore & Ohio R.R. Co.*, 374 U.S. 1, 4–5, where it was held that a court of appeals' rule limiting *en banc* consideration only where voted by *each* of the active circuit judges would be sustained despite the language in the statute to the effect that "a hearing or rehearing before the court in banc * * *" might be "ordered by a majority of the [active] circuit judges * * *."

Texas Gulf shares (see pages 13–14, *supra*). By virtue of the *en banc* opinion of the court of appeals, Mr. Crawford has at least as much guidance as to the appropriate meaning of the word "material" as he would have with respect to the application of that word in federal criminal statutes dealing with perjury and false filings. See 18 U.S.C. 1621 and 1001.

The additional constitutional arguments raised by various of the individual petitioners (HDC Pet. 22–23) are based on the assumption that the relief granted by the district court constituted a penalty. As we have seen, pages 43–44, *supra*, this is not so.

CONCLUSION

For the foregoing reasons, the petitions for writs of certiorari should be denied.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.

G. BRADFORD COOK,
General Counsel,
DAVID FERBER,
Solicitor,
FRANK E. KENNAMER, JR.,
Assistant General Counsel,
HARVEY L. PITT,
Special Counsel,
STUART A. MORSE,
Attorney,
Securities and Exchange Commission.

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1971

Docket No. 71-346

DAVID M. CRAWFORD,

Petitioner,

against

SECURITIES AND EXCHANGE COMMISSION,

Respondent,

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

---

PETITIONER'S REPLY BRIEF

David M. Crawford, pro se
200 Park Avenue
New York, New York 10017

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PETITIONER'S REPLY BRIEF

INTRODUCTORY STATEMENT

Respondent cites as authority more than one hundred cases many of which were decided after petitioner's case. The developing body

of precedent based on petitioner's case should not be permitted to proliferate without review of novel and important principles by this Court.

New law that flouts due process and equity would be established by respondent, the SEC and the lower courts. It will require a full briefing and oral argument to apprise this Court of the many important substantive and procedural aspects of this case.

Until now this case has been injustice in the name of equity and an alarming perversion of our judicial traditions. If the inscription above this Court "Equal Justice Under Law" also means "Equal Justice under Equity" this case merits this Court's review.

I

PETITIONER DID NOT WAIVE ORAL ARGUMENT

Without citing any authority respondent contends that petitioner by failing to object to the order of May 2, 1968 waived oral argument before a statutory quorum of the en banc court (Res. Br., p. 47).

This Court has recognized that plain error of a fundamental nature can be raised at any stage of the proceeding by a party or by the court. This Court has said:

> "The District Court treated the refusal to comply with its order as a contempt and committed the petitioner therefor. Neither in the Circuit Court of Appeals nor here was this action assigned as error. We think, however, that in the light of the provisions of Rule 37, it was plain error of such a fundamental nature that we should notice it." Bertha J. Sibbach v. Wilson and Co., Inc. 312, U.S.1 at 16 (1940).
>
> See also, Moore 1970 Rules Pamphlet pages 851-852, 878, 880.

The Sibbach precedent for considering questions of fundamental error at any stage of the proceeding was recognized by this Court in its consideration of 28 U.S.C. 46 when the Solicitor General first raised the question of the interpretation of that section in his petition for writ of certiorari in U.S. v. American Foreign S.S. Corp. 363 U.S. 685 (1960). In the Court of Appeals Government counsel had not raised the question of the correct interpretation of 28 U.S.C. 46 and it was not until the question was raised in the dissenting opinion that the Solicitor General successfully urged the point in his petition for certiorari.

Following that precedent, even if petitioner had not on two previous occasions raised the question of oral argument before a statutory quorum of the en banc

court, such fundamental error would still be ripe for consideration by this Court.

Even if waiver of oral argument before a statutory quorum of the en banc court were possible, any such waiver by petitioner would have to implied, since none was expressed.

The Government infers waiver of oral argument because following the Court's order of May 2, 1968, which stated that the case would be considered "without further argument" (C.A.2 Docket No. 30882) "No motion for leave to present additional oral argument was made by any of the parties at that time" (Res. Br. p. 47).

However, at the first opportunity, in accordance with Rule 40 of the Federal Rules of Appellate Procedure, petitioner's counsel in his timely petition for rehearing specifically raised the issue that petitioner ought to be permitted oral argument before a statutory quorum of the en banc court. (Crawford Petition 9/8/71, Addendum 4).

In denying the petition for rehearing the Second Circuit ignored petitioner's affirmative and timely assertion that the Second Circuit had violated the procedure governing appeals proscribed by 28 U.S.C. §46.

Respondent cites Federal Communications Commission v. WJR 337 U.S. 265, 275 as authority for the Second Circuit's

denial of oral argument (Res. Br. p. 47), but that case involved denial of oral argument in the course of an administrative proceeding pursuant to a Federal statute which spelled out the procedure to be followed, and did not involve the question of denial of oral argument before a Court of Appeals.

Respondent also cites Rule 2 of the Federal Rules of Appellate Procedure to justify the Second Circuit's violation of 28 U.S.C. 46 (c) and (d) (Res. Br. p. 48). Even if Rule 2 can gloss the controlling statute the Second Circuit's order was effective May 2, 1968 and Rule 2 did not become effective until July 1, 1968.

Despite the SEC's efforts to convince the Court of Appeals that petitioner had waived oral argument before a statutory quorum of the en banc court, the court below did not refer to waiver in its opinion 446 F. 2d. 1301.

A resolution adopted by the Judicial Conference of the United States October 29, 1971 is additional authority that deviation from statutes governing appeals in the Federal Courts ought not be permitted without the express agreement of counsel. Paragraph VI of that resolution provides in part:

> "If practicable and agreeable to counsel the Court of Appeals may...permit submission without argument..."

Denial of oral argument before a statutory quorum of the en banc court has not been agreeable to petitioner's counsel. Moreover timely objection in his petition for rehearing September 20, 1968 and in his appeal to the Second Circuit, May 11, 1971, make clear that petitioner never expressly or impliedly waived oral argument before a statutory quorum of the en banc court.

II

ABSENCE OF FAIR WARNING

Fair warning in this case ought to be judged bearing in mind that petitioner has been found to have violated a statute sounding in fraud and deceit and enjoined for life from further violation because he purchased 600 shares of his company's stock believing that disclosure of important news concerning his company had already been made (320-1 JA).

Respondent contends (Res. Br. pp. 36, 37, 46) that the interpretation of §10(b) and Rule 10b-5 was well established at the time of petitioner's purchase so that the due process clause of the Fifth Amendment and well settled principles of administrative procedure were not violated. The fact is that prior to the act complained of there had been no judicial interpretation of the section or the rule which held that an act such as petitioner's violated either the statute or the rule.

Of the twenty cases respondent cites as affording petitioner "ample notice," ten were administrative proceedings, five of which were settled, so that the applicability of §10(b) and Rule 10b-5 to petitioner's facts had never been judicially determined in those proceedings (Res. Br. pp. 36,37, ns 41,42,43).

Of the ten judicially determined cases cited by respondent (Res. Br. p. 36 n. 41) three were decided after April 16, 1964, the date of the action complained of, so they could not have furnished petitioner with notice. None of the other seven cases cited by respondent concern an employee who, believing that news of a material fact concerning his company has already been announced, purchases his company shares.

Even if Cady,Roberts and Co. 40 SEC 907, an administrative proceeding of first impression not judicially reviewed, is regarded as precedent, it was misinterpreted by the District Judge and incorrectly applied to petitioner's case. The District Judge held that Cady,Roberts ruled that as soon as an announcement was released insiders could trade. (App. 42a). However, the Court of Appeals held that the District Judge misinterpreted Cady,Roberts and reversed him (App. 97a).

If Federal Court judges after months of deliberation can disagree as to the "SEC/Cady,Roberts" interpretation of Rule 10b-5, how can it be held that petitioner had "ample notice" of the "SEC/Cady,Roberts" interpretation?

Nor was that the only questionable interpretation of Cady, Roberts by the lower courts. In Cady, Roberts the Commission after talking about a "special obligation" traditionally required of corporate insiders, defined the obligation as resting on two principal elements. One of these elements was "the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing" (40 SEC 912). The phrase "knowing it is unavailable to those with whom he is dealing" distinguishes petitioner's case because at the time he ordered his shares he believed the material information was available to others (320-1 JA).

Moreover in Cady, Roberts the SEC found no fault with Cowdin, a Director of the company concerned as well as a registered representative of Cady, Roberts, who telephoned a partner in Cady, Roberts before the news of a dividend cut had been announced. In absolving Cowdin the SEC said that he "...probably assumed without thinking about it, that the dividend action was already a matter of public information.." (Id 917).

Petitioner testified that he believed the news was in the public domain at the time he placed his purchase order (320-1 JA), and there was no evidence introduced that this was not his belief, for there is none. Yet petitioner is held on the basis of Cady,Roberts to have had notice that

such a purchase violated Rule 10b-5 and he is enjoined for life because of it. Such is the "ample notice" which purports to satisfy the "due process" requirements of the Fifth Amendment of our Constitution.

III

"AD HOC LITIGATION" OF RULE 10b-5 HAS BEEN UNFAIR AND CONFUSING

Respondent would lull the court into believing that proceeding "...by individual, ad hoc litigation..." rather than by regulation has been satisfactory. (Res. Br. p. 47). On the contrary it has been unfair and confusing. Attesting to the unfairness and confusion, a District Court Judge after long consideration of a §10b, Rule 10b-5 case recently wrote:

> "Particularly where the law is changing, retroactive application by courts of unreasonably strict standards of disclosure can be quite unfair to those who acted in good faith and without violating any reasonable fiduciary standards. See e.g., as to contemporary confusion on the issue..." (Citing numerous articles) Dolgow v. Anderson CCH Fed. Sec. L. Rep. par. 93,249 (Oct. 21, 1971).

In electing to proceed "...by individual, ad hoc litigation..." rather than by regulation, the SEC has avoided its

own responsibility and unreasonably burdened the judiciary with the unnecessary task of clarifying Rule 10b-5. In this case both the District Court (App. 43a, 44a) and the Court of Appeals (App. 97a n. 18) have made clear that they believe the SEC should proceed by regulation in clarifying Rule 10b-5. The SEC has turned a deaf ear to the lower courts and it is time for this Court to speak.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari ought to be granted.

Respectfully submitted,

David M. Crawford
Pro se

December 7, 1971

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IN THE

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OCTOBER TERM, 1971

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v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

PETITION FOR REHEARING

David M. Crawford, pro se
200 Park Avenue
New York, New York 10017

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PETITION FOR REHEARING

Petitioner respectfully moves this Court for an order vacating its denial of his petition for writ of certiorari, entered on December 20, 1971, and granting the petition. In support of this motion, petitioner joins with Texas Gulf Sulphur Company et al, in Docket Nos. 327, 328, and 347.

I

An Injustice Has Been Done In the Name of Equity

One authority says of rehearings:

> "The standard, perhaps more precisely called ideal, which appears almost everywhere is that rehearing will be granted to avoid doing substantial injustice." 25 FRD 143 at 150

This is such a petition.

Petitioner asks each Justice to put himself in petitioner's place. Believing that news of his company's discovery was in the public domain and that it would be in the public domain for ten hours before his order could be acted upon, petitioner placed an order for his company's stock and for that action in a case of first impression was found to have violated a statute sounding in fraud and deceit and is enjoined for life -- the implication being that unless enjoined he will again violate the law.

The Government has succeeded in obtaining this permanent injunction despite a complete absence of evidence that there was any likelihood of a future violation by petitioner. Indeed there was no meaningful allegation or argument by the Commission that petitioner was likely to violate the law again. If there was no justification for an injunction to deter

petitioner then it is tantamount to punishment. Punishment is what the Commission sought and punishment is what the lower courts decreed.

The lower court proceedings of this case were well attended and extensively reported by representatives of such national newspapers as The New York Times and The Wall Street Journal. They were present when counsel for the Commission cast petitioner and other defendants in the role of criminal types deserving punishment; he said before calling petitioner as his first witness:

> "The Commission's objective in bringing these proceedings before the Court are to drag to light and pillory the misconduct of the individual defendants in these proceedings." (283 Joint Appendix)

Petitioner respectfully asks the Court to recognize that lives of respectable, law-abiding citizens, of which he is one, can be destroyed by interpretations of the securities laws which ensnare the innocent in ways never intended by Congress. Petitioner prays that in this case the Court will seize this opportunity to extend the high standard of interpretation of the securities laws announced in Reliance Electric Company v. Emerson Electric Company 40 LW 4125 decided January 11, 1972.

This Court devotes much time to protecting the rights of individuals in criminal proceedings and similar protection should be accorded the rights of individuals in an equity proceeding under the securities laws. This aspect of petitioner's case merits the Court's review.

II

The Court Has Been Reconstituted

Another substantial ground upon which the Court should grant this petition for a rehearing is the intervening circumstance that the Court has been reconstituted since the petition for certiorari was denied. At that time the Court was at little more than three-quarters strength. Now there are nine Justices, a full bench, to consider this landmark case. Rehearing in American Appellate Courts 25 FRD 143 at 151.

After the petition for certiorari was filed, the need for clarification of this case was attested to by Judge Kaufman who said of the Texas Gulf decision and Judge Waterman:

> "I need not speak at length about his many landmark opinions. His decision in Texas Gulf Sulphur, to take one of many instances, has become the Hadley v. Baxendale of securities law and is cited at length in every securities case that has since come before us -- usually by both sides." (Record of the Association of the Bar of the City of New York, November 1971, p. 659).

A petition based upon a case of this importance merits review and consideration by the full, reconstituted court.

CONCLUSION

For the reasons set forth in this petition for rehearing, as well as in the petition for certiorari previously filed, rehearing and certiorari should now be granted.

Respectfully submitted,

David M. Crawford, pro se
200 Park Avenue
New York, New York 10017

January 14, 1972

CERTIFICATE OF COUNSEL

I, David M. Crawford, do hereby certify that the foregoing petition for rehearing is presented in good faith and not for delay, and that it is substantially restricted to the grounds specified in Rule 58(2) of the Rules of this Court.

David M. Crawford